11

The Impact of Legal and Regulatory Forces

Microsoft is one of the most recognized business success stories in the world. The company's market value placed it second behind General Electric on *Fortune*'s 2002 list of the 500 largest corporations, and they rank 8th in terms of profits. Microsoft ranked 28th on *Fortune*'s 2002 list of the best companies to work for in America. And the company ranked fourth on *Fortune*'s list of "America's Most Admired Companies (behind General Electric, Southwest Airlines, and Wal-Mart).[1]

Yet both Microsoft's reputation and its managerial effectiveness have been tarnished and hampered by issues in the company's legal environment. For the most part, Microsoft's problems have been placed in the public spotlight through the work of the Anti-trust Division of the U.S. Department of Justice. The Department of Justice (and 19 states) sued Microsoft, alleging it monopolized the market for PC operating systems and engaged in anti-competitive practices to maintain its monopoly position. The suit and the publicity surrounding it have been embarrassing and costly for the company.

Microsoft was found guilty of monopolizing. The government considered requiring a breakup of Microsoft but finally settled for an agreement whereby Microsoft would change various practices. Among monopolistic practices Microsoft agreed to eliminate were bundling its software products with Windows to exclude rival software products and failing to give competitors the technical data they needed for their software to run smoothly with Microsoft products. Although the federal government and Microsoft reached agreement, nine state governments and the District of Columbia refused to accept the accord. They thought that the decision was too easy on Microsoft. Consequently, in the summer of 2002, the federal court was still hearing arguments before making a final decision.

Microsoft's legal entanglements don't end there. The company recently settled a dispute with the Securities and Exchange Commission over accounting practices. That settlement followed earlier settlements of a number of other lawsuits involving temporary workers, competitors, and customers.

Microsoft's CEO Steve Balmer viewed these legal environment challenges not only as a business expense to be avoided if possible but also as a dangerous diversion of management time. He also has realized that the company's legal woes have led to skepticism and distrust within the industry. In response, he has started communicating with critics and even rivals such as Larry Ellison of Oracle. He's even listed as one of his goals for the company to "learn to be respectful and open and honest." It's a goal that some observers feel was prompted by the tenacity of the legal and regulatory environment.[2]

Modern businesses deal with an elaborate system of laws and regulations. Business owners cannot survive without basic knowledge of these laws and regulations. Therefore, it is important for you to understand the basic legal and regulatory forces that affect business.

After studying this chapter you should be able to:

1. Describe the basic philosophy underlying the legal environment of a capitalistic society.
2. Explain how government regulations actually support business.
3. Explain the various ways government regulates business in the United States, and especially the legal and regulatory impacts on the following issues:
   - Monopoly and antitrust.
   - Industrywide regulations.
   - Employee relations.
   - Financial.
   - Consumer relations.
   - Environmental.
   - City, county, and state regulations.
4. Explain the impact of taxes on business.
5. Discuss the effect of the legal environment on the firm's global competitiveness.
6. Explain the relationship between business ethics and the legal environment of business.

This chapter is divided into six sections. The first helps you understand the basic relationship between government and business. The second explains some of the ways government supports business. The third helps you understand the major ways government regulates business. The fourth discusses the impact of taxes on business. The fifth points out the relationship between the global environment and government regulation within a country. The last discusses the relationship between the legal environment and business ethics. Together, these elements constitute the legal and regulatory forces that are among the environmental influences on a successful business, as shown in the model in Chapter 2.

To understand the essence of this chapter, consider an analogy between business and a basketball game. The competing business firms are like the competing basketball teams. The CEOs are somewhat like the coaches. The game is played with a number of rules. Many of the rules are well known and cannot be violated, such as the number of minutes in the game, the number of allowable fouls per person, and the dimensions of the court and its markings. Other rules encourage players and coaches to act in certain ways even though they do not have to—for example, shooting from behind the three-point line and taking the opportunity for time-outs. Players do not have to shoot from beyond the three-point arc, but they can earn higher scores if they do. Similarly, the coach does not have to call time-outs but can if desired. Other rules control the flow of the game and the behavior of players. Unwarranted contact between players elicits a foul call from the referee. Taking excessive steps before shooting results in a turnover. However, as long as they operate within the rules, the teams are allowed considerable discretion in how they play the game.

Business operates in much the same fashion. Some rules and regulations simply define the nature of business and are freely accepted by all involved. Some regulations penalize businesses for infractions or inappropriate behavior. Other regulations encourage certain types of behavior. For example, tax regulations allow businesses to deduct expenses from their revenues. The managers do not have to deduct the expenses but can reduce their taxes if they do. The government is analogous to the referees. However, you will also learn from this chapter that some of the rules and regulations are designed so that businesses can do things without government involvement.

Freedom, Property Rights, Risk Taking and Responsibilities

> **freedom**
> The power to make one's own decisions or choices without interference from others.

Before we discuss various parts of the legal environment, we will review the basic philosophy of a capitalistic society. Four concepts are important. The first is **freedom,** the power to make one's own decisions or choices without interference from others. Freedom is one of America's most cherished values. The Constitution of the United States and the accompanying Bill of Rights were designed to promote and protect freedom for all individuals and, by extension, for the businesses they choose to operate. Consequently, many of the laws we will be reviewing in this chapter are designed to restrict the actions of the few to protect the freedom of the many.

> **property rights**
> The freedom to possess and regulate the use of tangible items (such as land and buildings) and intangible items (such as a copyrighted piece of music or a patented invention).

Second is the concept of **property rights,** the freedom to possess and regulate the use of tangible items (such as land and buildings) and intangible items (such as a copyrighted piece of music or a patented invention). The right to hold and use private property is one of the freedoms protected by the Constitution, and it is a key feature of the American business system. Private property is also a key feature of the economic system within which business operates, and it differentiates a free market economy from a socialist economy. A major purpose of the American legal environment is the protection of property rights.

A third concept is **risk taking,** which means that businesses are willing to undertake actions without knowing for sure what the results will be. Risk taking is necessary for economic growth to take place. Managers are willing to take risks because they are confident that, if their gambles succeed, they will make a profit. The legal environment of business has an important role to play in encouraging risk taking through entrepreneurship.

risk taking
The willingness to undertake actions without knowing what the results will be.

The fourth concept is responsibility. Along with the property rights of the businessperson is the requirement that the property be used in a socially responsible manner. **Responsibility** means using one's property (both tangible and intangible) in a manner that does not unduly infringe on the freedom of others. Rights and responsibilities go together. Just as the law upholds property rights, it also encourages the property owner to behave responsibly.

responsibility
The use of one's property (both tangible and intangible) in a manner that does not unduly infringe on the freedom of others.

Much of this chapter will discuss laws that seem to limit the freedom of business. In a broader sense, however, the law generally encourages managers to behave responsibly so that freedom will be protected in the long run. Furthermore, some laws explicitly expand the freedom of business with the expectation that responsible businesspeople will use that freedom to better serve their customers and other stakeholders.

Government Support of Business

We begin with a discussion of five legal situations that encourage business investment and risk taking. These regulations actually benefit businesses by encouraging them to take risks associated with operating a business. They are listed in Table 11.1.

Supporting Business through Limited Liability

Chapter 3 discussed four ways to form companies: the sole proprietorship, the partnership, the limited liability company (LLC), and the corporation. Two of these, the limited liability company and the corporation, have as their most salient characteristic limited liability for the owners. You may recall from that discussion that creditors of sole proprietorships and partnerships can seize both business and personal assets of the owners if necessary. However, the LLC and the corporation do not have that risk; the owners can lose only as much as they have invested in the company. This limitation on personal liability encourages owners of high-growth or risky businesses to invest in the businesses without fearing the loss of their personal assets. Recall, too, that LLCs provide this limited liability protection while allowing the owners to report the business taxes on their own tax forms.

TABLE 11.1
Ways Government Supports Business

1. Limiting ownership liability.
2. Limiting losses through the use of bankruptcy laws.
3. Protecting innovation through copyrights, trademarks, and patents.
4. Providing structure through establishment and enforcement of rules and industry standards.
5. Encouraging competition by limiting monopoly power.

Assisting Business with Bankruptcy Laws

bankruptcy
A situation in which a firm does not have the money to pay its debts.

One of the risks of doing business is the possibility of going bankrupt. In **bankruptcy,** the firm does not have the money to pay its debts. Bankruptcy laws give business owners a second chance to succeed.

There are two major types of bankruptcy provisions. One type deals with liquidation, and the other deals with restructuring. A Chapter 7 bankruptcy (called that because its rules are set out in Chapter 7 of the bankruptcy regulations) frees the owner of a failed business from liability for all debts beyond those that can be paid out of the sale of the firm's assets. In other words, the business owners can keep personal assets, but the business assets must be liquidated and the business ceases to exist. The owner's business assets are given to a bankruptcy trustee, who sells them and divides the proceeds among the creditors. Again, the owner keeps personal residence, car, personal and household items, and tools of the trade. That makes it possible for the bankrupt owner to start over in business.

In a Chapter 11 bankruptcy, the business reorganizes and reaches agreement with its creditors about repayment of debts. The business is not forced to cease operations. It continues in hopes of turning the situation around. This approach is possible if the business has a long-term prospect of being able to pay its obligations, even though it cannot do so in the short run. A repayment plan must be approved by the court and the creditors. Some companies emerge from Chapter 11 bankruptcy and eventually become competitive and successful again. That is the hope of Kmart, which sought bankruptcy protection on January 22, 2002. The company cut expenses and planned to close 283 of its 2,105 stores. But it continued to operate most of its stores while it proceeded to reorganize under court supervision. The reorganization will have to give first consideration to satisfying creditors to whom Kmart owes substantial sums of money—bankers, landlords, suppliers, and bondholders. But shareholders held out hope that there would be something left for them, and Kmart's stock continued to trade on the New York Stock Exchange.[3]

Encouraging Risk Taking with Copyrights, Trademarks, and Patents[4]

copyright
The exclusive right to the use of intellectual property such as books, photographs, music, or cartoons.

trademark
The exclusive legal right to the use of a name, symbol, or design.

patent
A government-protected legal monopoly on a product or product design.

We began this chapter by pointing out that risk taking is a major function of the successful business. We also said government reduces risks by providing for organizational forms that limit liability. Copyrights, trademarks, and patents are other methods that government uses to encourage risk taking.

A **copyright** gives the holder the exclusive right to the use of intellectual property such as books, photographs, music, or cartoons. This protection encourages individuals or companies to produce products without the fear that someone else will duplicate them. A copyright lasts for the life of the author plus 70 years.

A **trademark** gives exclusive right to the use of a name, symbol, or design. Companies make extensive use of trademarks to identify their goods and services. Trademarks are good for 6 years and may be renewed for an indefinite number of 6-year periods.

Look at Profile 11.1. How many trademarks do you recognize? As you study them, you should get a sense of why they are so important and why companies vigorously protect them.

A **patent** is a government-protected legal monopoly on a product or product design. Knowing that their products are protected for an extended period of time (20 years) and that other companies cannot produce identical or virtually identical products encourages firms to engage in research and development.

SOME WELL-KNOWN TRADEMARKS

PROFILE 11.1

Trademarks are a valuable marketing tool. Successful trademarks are widely recognized. How many of the famous trademarks below can you recognize? Answers: Top row, left to right: Boise Cascade, Delta Airlines, United Airlines. Second row, left to right: Sprint, Adobe, DaimlerChrysler. Third row, left to right: United States Postal Service, Honda, Best Buy. Bottom row, left to right: Toyota, Southwest Airlines, Dell.

All of our focus companies use trademarks. (The logos we use for our focus company examples are trademarks, and we use them with the permission of the companies.) All of them have invested heavily in establishing a reputation that customers know and trust. It is important to them that no competitor be able to sell competing products or open a competing airline or run a competing retail business that uses the same name. This may seem like a trivial point since you probably never see that type of competition. But that is because trademark protection makes it illegal to use a business name or logo that is the same or essentially the same as that of another firm. From time to time you may read about an unknown firm that has been illegally using the name of a well-known trademarked firm. Some firms are absolutely relentless in searching out and stopping such activities. They will contact the offending company and threaten (or take) legal action if the practice is not stopped immediately.

Some companies base their business model on patent protection. Most large pharmaceutical firms fall into this category. They rely on a small number of patented drugs for current income and on the development and patenting of new drugs for their future income. Merck has been an outstanding example of such a firm. Patent protection motivated Merck to produce such recently successful drugs as Pepcid (antacid drug), Vasotec and Prinivil (hypertension drugs), and Vioxx (anti-inflammatory pain-killing drug). But in 2002, the large profits provided by these drugs were threatened by patent expiration, competition, or (in the case of Vioxx) concern over side effects.[5] Patent protection doesn't eliminate business risks, and it doesn't last forever, but it does increase the supply of new products. Check out Profile 11.2 to see another example of a company working with its patents.

PROFILE 11.2 ASTRAZENECA STRETCHES A PATENT'S LIFE

The American patent system is based on the expectation that the firm holding the patent will legally charge a high price during the patent's life. That is the reward thought to be necessary to motivate research and development for new products and processes. But once the patent has expired, it is also expected that legal, copycat versions of the product or process will be introduced by competitors, and the price will fall sharply.

That scenario often does occur. But in some cases, significant competition fails to develop immediately. AstraZeneca's handling of its best-selling heartburn drug, Prilosec, is an example. The patent on the high-priced drug expired in April 2001. A year later no generic competing drugs had been introduced. AstraZeneca was still selling Prilosec for the high price of $4 per pill.

How did AstraZeneca manage that feat? Six years before the patent expired, the company formed a team of lawyers, marketing experts, and scientists, and instructed them to develop a strategy to prevent post-patent competition. The team considered dozens of options and finally settled on a two-part strategy. First, AstraZeneca would develop an improved successor product, Nexium, and convert Prilosec users to the new heartburn drug. Second, the company would extend the life of the existing patent by making minor changes in the product, such as adding a layer of coating, and then re-patenting the product.

The first part seems consistent with the spirit of patent law philosophy. But the second action might be considered an abuse of the patent system. What do you think?

Interestingly, AstraZeneca has an additional strategy in the works. The company has appealed to the Food and Drug Administration (FDA) for permission to sell Prilosec as an over-the-counter antacid medicine. If FDA permission is granted, AstraZeneca will then have Nexium as a prescription drug and Prilosec as a similar nonprescription drug.

Source: Gardiner Harris, "As a Patent Expires, Drug Firm Lines Up Pricey Alternative," *The Wall Street Journal,* June 6, 2002, p. A1, A10; and Jill Carroll, "FDA Advisers to Review AstraZeneca's Prilosec," *The Wall Street Journal,* June 21, 2002, p. B2.

Encouraging Business with Rules and Industry Standards

Industry standards can promote business investment by encouraging product standards, process standards, or other rules of competition for a given industry. Working relationships between government and industry are not new. Safety standards for many consumer products are a result of cooperation between the relevant industry groups and the *Consumer Product Safety Commission (CPSC).* These standards are designed to protect consumers and to give manufacturers opportunities to develop new products that are safe as well as competitive.

It might appear that establishing and enforcing rules and industry standards would not be conducive to business operations, but doing so may actually be one of the greatest services that government provides. The establishment of clear sets of rules and guidelines, coupled with their fair enforcement, provides a structure, much as the rules regarding fouls and substitutions provide structure for a basketball game. When managers know what the rules are and how they will be enforced, they are more likely to continue investing in a given industry. Consider the free trade agreements we discussed in Chapter 10. Rules that govern movement of goods across borders let businesses know exactly how imports and exports will be handled. In addition, the regulations of NAFTA, for example, encourage American businesses to increase production of products for export to Canada and Mexico.

Southwest Airlines' struggle to get started illustrates both how a set of rules can help a business and how established firms can use the rules to suppress innovation. As soon as Southwest received its charter from the Texas Air Commission, one of its competitors, Continental Airlines, went to court and obtained a temporary order forbidding Southwest to fly until a trial had been held to determine whether a charter should have been granted. The trial took place in the district court in Austin, Texas, and three established airlines—Braniff, Texas International, and Continental—argued that Southwest should be denied the right to fly. Southwest was represented by its co-founder and company attorney, Herb Kelleher. The trial court ruled that there was not enough traffic to support more than the existing carriers, so it denied Southwest permission to fly. Southwest appealed to the appellate court, where it lost. It appealed again to the Texas Supreme Court, and this time Kelleher won. But the established airlines then appealed to the U.S. Supreme Court. That court refused to consider the appeal, leaving Southwest Airlines the winner, with full rights to fly passengers between the three Texas cities.[6]

SOUTHWEST

When Southwest entered the airline business, Kelleher knew the rules of the game well enough to anticipate the possibility of legal opposition by the established carriers. However, he also knew the rules well enough to know he would get several opportunities to present his case in court. He had enough faith in the basic fairness of the process that he expected to win because the economic facts were on his side.

Encouraging Business by Protecting Competition

In the next section, we will discuss how government regulates the behavior of businesses. One important aspect of regulation is the regulation of monopolies. We will see that in some cases monopoly power hinders consumers, while in other cases monopoly power harms competition among businesses. This second type of situation might involve a single firm's gaining too large a share of the market. Or it might involve several firms trying to eliminate or at least cripple a potential rival. Southwest Airlines faced just such a situation. Even after it won the suit allowing it to fly, other airlines kept up the pressure. Braniff and Texas International Airlines (TIA) wanted Southwest's underwriters to back out of their agreement to manage Southwest's first public stock offering. Southwest found another underwriter. Next Braniff and TIA obtained a court order to keep Southwest from scheduling flights opposite theirs. Kelleher appealed to a higher court and won. The competitors then attempted to keep Southwest from participating in the airline credit card system, pressured suppliers to refuse to sell to it, and kept it from using the fuel hydrant in Houston. Eventually, the other airlines were indicted by the U.S. government for conspiring to restrict competition and put Southwest out of business. The government used the antitrust laws to punish the rivals, and they were each fined $100,000.[7]

Government Regulation of Business

antitrust laws
Laws that prohibit companies from unfairly restricting competition.

Up to this point you have been learning about the ways government and the law make it easier for firms to do business. However, businesses must also comply with laws and regulations imposed by the federal government as well as those created by states, counties, and cities. This chapter focuses on some of the key federal laws. Keep in mind, however, that firms must be alert to all the legal requirements wherever they do business including state and local requirements. Let's take a look at some of those key federal laws and regulations.

Regulation of Monopoly

One of the social problems created by some large corporations is monopoly power. Recall that a monopoly exists when there is only one firm selling a product or service. All countries show some concern for this problem, but no country has attacked it more enthusiastically than the United States. Table 11.2 presents an overview of some of the key laws in this area.

The most significant monopoly-related regulations deal with antitrust issues. **Antitrust laws** prohibit companies from unfairly restricting competition. The first major American antitrust law was the 1890 Sherman Antitrust Act, which was expanded by the Clayton Act of 1914 and further enhanced by the Federal Trade Commission Act of 1914. These laws are enforced by the U.S. Department of Justice and the Federal Trade Commission (FTC). There have been various changes to the antitrust laws over the

THINK ABOUT THIS

1. Many people don't think the government does much good in its efforts to support business. How would you respond to someone who is critical of the government's role?
2. Government rules and regulations help business because they provide stability and limit business because they impose restrictions. Is one role more important than the other? Why?
3. Copyrights owned by businesses last for 70 years. Patents are good for 20 years. Are these limits too long? Why do you think the government set such long limits?

TABLE 11.2

Key Laws Regulating Monopolies

Interstate Commerce Act (1887)
- Established the Interstate Commerce Commission (ICC).
- Outlawed price-fixing and discrimination practices in the railroad industry.

Sherman Antitrust Act (1890)
- The first federal antitrust act (indeed, the term *antitrust* comes from this act).
- Aimed at preventing big businesses from combining, concentrating their power, and blocking the competitiveness of smaller businesses.
- Because of vague language and problems with enforcement, the act was not very effective.

Clayton Act (1914)
- Prohibits specific actions that hurt competition.
- Established remedies, such as injunctions, to stop actions that harm competition.
- Allows for remedies, such as suits and damages, for violation of the act.

Federal Trade Commission Act (1914)
- Established an independent agency, the Federal Trade Commission (FTC), to enforce antitrust laws.

Robinson–Patman Act (1936)
- Strengthened the Clayton Act by prohibiting price discrimination.
- Prohibits predatory pricing, specific pricing practices designed to restrict or exclude competition.

Wheeler–Lea Amendment (1938)
- Made "unfair or deceptive acts or practices," such as deceptive advertising, unlawful.

Cellers–Kefauver Act (1950)
- Prohibits mergers that hurt competition.

years, but the basic principles and enforcement agencies have remained the same. Among the several ways that companies may be affected are three that deserve further comment—monopolization, price-fixing, and mergers.

Monopolization refers to a situation in which a single firm controls all or most of a market. Although occurring infrequently, monopolization cases grab headlines when they do occur. You may have already studied the 1911 monopolization case that caused the breakup of Standard Oil Company of New Jersey. More recently, IBM was the target of an antitrust suit that dragged on for 14 years before ending in 1982. The government finally dropped that case because technological change and new competition was thought to have destroyed IBM's monopoly position. The experience of Microsoft in the introduction to this chapter is an even more recent example.

> **monopolization**
> A situation in which a single firm controls all or most of a market.

Many businesses periodically become frustrated by the stiff price competition of their rivals. On occasion, those frustrated businesses consider **price-fixing,** which occurs when rival firms agree to charge the same price for their competing products. Their argument is that they all make more money if all competitors agree to raise their prices. Fixing prices, however, hurts customers because they no longer have a choice among variously priced products.

> **price-fixing**
> A situation in which rival firms agree to charge the same price for their competing products.

A dramatic example of price-fixing involved Archer Daniels Midland (ADM), one of the world's leading processors of oilseed and corn. The company announced that it was being investigated for engaging in price-fixing in three of its product lines. Various reports that followed indicated that ADM had encountered sharp price competition from an oligopolistic rival and had attempted to convince that rival that it was in the best interests of all competitors to agree to refrain from price competition. ADM pled guilty to charges of price-fixing in two product areas, citric acid and an animal feed supplement called lysine, and agreed to pay $100 million in penalties for violating the law. That was the largest price-fixing fine ever won by the U.S. Department of Justice.[8]

ADM's troubles are still not over, however. In 2002, the seventh U.S. Court of Appeals reinstated a lawsuit from the earlier case, this time focusing on corn sweetener that is used in everything from soft drinks to candy. This suit contends that Archer Daniels Midland and co-conspirators rigged prices in what is now a $2.4 billion market.[9]

Although price-fixing is illegal, it still happens occasionally. The government periodically uncovers examples and puts a stop to them. But it is likely that many other cases go undetected. Price-fixing is not only a legal matter but also an ethical issue. Ethical business managers refuse to participate in price-fixing schemes on both legal and moral grounds.

Another area in which the government antitrust agencies affect businesses is that of mergers and acquisitions. As you learned in earlier chapters, a merger occurs when two firms join to become a single firm. An acquisition occurs when one firm buys a second firm. Sometimes a merger or acquisition is between firms that compete with one another (a horizontal merger), sometimes the merging firms are in unrelated lines of business (a conglomerate merger), and sometimes the merger is between a firm and its supplier or customer (a vertical merger). Two of our focus firms have used mergers as part of their expansion strategy. Southwest Airlines acquired a small discount airline named Morris Air to add new routes to its offerings. Best Buy acquired Sam Goody music stores.

industrywide regulation
A situation in which a local, state, or federal government controls the entry of firms into an industry, the prices they charge, they way they operate, or even their exit from the industry.

A merger is one way for a firm to expand, but it can also be the source of increased monopoly power. Antitrust laws attempt to stop mergers that will lead to monopoly power by significantly restricting competition. This is especially true in the case of horizontal mergers. Whether or not a merger does pose enough of a threat to be stopped by the government is a judgment call by either the Justice Department or the Federal Trade Commission. Consequently, before a business undertakes a merger, its management should consult with legal experts regarding whether or not the intended merger is likely to be challenged by the government.

Mergers and acquisitions are ways businesses can grow and strengthen their competitive positions. They can also signal antitrust concerns. Do you think Best Buy's acquisition of Sam Goody threatens to create monopoly power that significantly restricts competition?

Industrywide Regulation and Deregulation

Industrywide regulation refers to a situation in which a local, state, or federal government controls the entry of firms into an industry, the prices they charge, the way they operate, or even their exit from the industry. In the United States, this form of legal restriction has historically been found in such industries as electrical and gas utilities, telephone service, banking, railroads, trucking, and the airline industry. This kind of regulation began in 1887 when the federal government created the Interstate Commerce Commission to regulate the railroads.

American experience with regulation has produced mixed results. It can be argued that the regulators prevented potential abuses of monopoly power, which some of the regulated firms would have naturally enjoyed. It can also be argued that in some industries, such as trucking, there would not be monopoly power even without regulation. Furthermore, even in those cases where economies of scale or other factors justified monopoly, it often seemed that regulation encouraged inefficient practices by the firms' managers.

Because of these inefficiencies, the U.S. government began a process of deregulation in the late 1970s. Deregulation usually occurred in situations in which it was possible to introduce genuine competition.

In some industries, the expected competition failed to appear or was short-lived and the possibility of reregulation arose. This situation occurred in the local cable TV industry. Cable subscription prices rose sharply under deregulation, consumers complained, and the federal government reinstated local price regulation. In the airline, electric, and telecommunication industries, as reported in Profile 11.3, deregulation is now under review partly because of failures of competition to work as expected.

THE DEREGULATION ISSUE: EFFICIENCY AND INNOVATION VERSUS STABILITY AND SECURITY

PROFILE 11.3

During the 1990s, three major American industries were freed from a host of regulations, and expectations were high for lower prices and a faster pace of innovation. But unexpected problems emerged in 2000 through 2002. In California, deregulation of the electricity industry led to temporary capacity shortages and price hikes, which led to calls for a return to regulation. The financial health of most of the nation's airlines was jeopardized by suicidal price wars. Additionally, the major firms in the telecommunications industry were suffering large financial losses and huge layoffs as a result of serious overbuilding.

The problems encountered by these three formerly regulated industries suggested that America may need to rethink its approach to deregulation during the next few years. Economists had an explanation for the problems of the airline, electricity, and telecommunication sectors. All three industries were so-called increasing returns businesses. This means that they incurred heavy capital costs before they started selling their services; but once capacity was in place, they could cut prices drastically as sales increased and still make a profit. That is, they could still make a profit since there were no competitive pressures. But deregulation meant there was competition. Firms rushed to build more capacity than their competitors in the hope of being the profitable, surviving firm. Firms made temporary price cuts below costs to capture more of the market. They expected to raise prices once their rivals had been driven into bankruptcy. This combination of economic forces was causing concentration of ownership (tending toward monopoly), huge price differences for customers in competitive market segments versus those in areas that offer no choice, and violent swings in investment. At the same time, technological progress had picked up.

In summary, America's deregulation experience through 2002 shows that deregulation brings two benefits (efficiency and technological progress) but forces society to give up two other benefits that come with regulation (stability and security of supply). Government's challenge in the next few years is to find ways to get a better balance of the conflicting benefits of regulation and deregulation.

Source: Peter Coy, "Deregulation: Innovation vs. Stability," *BusinessWeek,* January 28, 2002, pp. 108–109.

Regulation of Employee Relations

The U.S. government has developed an extensive array of laws and regulations that affect companies' relations with their employees. These fall into three broad categories: discrimination, working conditions and compensation, and unionization. In addition, many state governments have similar laws.

Employment Discrimination

Many federal, state, and local laws are designed to prevent employment discrimination. Perhaps the best known of these is Title VII of the 1964 Civil Rights Act, which prohibits employment discrimination based on race, color, religion, sex, or national origin. Subsequent federal laws also prohibit discrimination based on pregnancy, age (for those over 40), and disability. State and local laws may create additional protected classes. These laws are designed to keep businesses from discriminating in hiring, pay, promotion, or termination procedures. Table 11.3 gives an overview of some of the important laws that address discrimination in employee relations.

TABLE 11.3

Key Laws Dealing with Employment Discrimination

Equal Pay Act (1963)

- Protects men and women who perform substantially equal work in the same establishment from sex-based wage discrimination.

Title VII of the Civil Rights Act (1964)

- Prohibits employment discrimination based on race, color, religion, sex, or national origin.

Age Discrimination in Employment Act (1967)

- Protects individuals who are 40 years of age or older from age-related discrimination.

Sections 501 and 505 of the Rehabilitation Act (1973)

- Prohibit discrimination against qualified individuals with disabilities who work in the federal government.

Title I and Title V of the Americans with Disabilities Act (1990)

- Prohibit employment discrimination against qualified individuals with disabilities in the private sector and in state and local governments.

Civil Rights Act (1991)

- Provides monetary damages in cases of intentional employment discrimination.

The purpose of affirmative action programs is to create a level playing field for all individuals regardless of race or gender. However, in recent years, these programs have come under fire because they give preference to women and minorities in hiring decisions. Some states are moving to either remove or reduce the impact of affirmative action programs on businesses. This issue will likely be a topic of consideration for courts and legislatures for a number of years.

Another important issue facing businesses today is sexual harassment. Although it is not specifically covered in Title VII, the courts have since ruled that sexual harassment constitutes a form of sex discrimination that violates Title VII. The most explicit sexual harassment occurs when hiring, promotion, or benefits are contingent upon sexual favors. But sexual harassment also encompasses the presence of a *hostile work environment.* This includes unwelcome comments and conduct, as well as behaviors that are seen as offensive.

To appreciate the range and nature of federal job discrimination regulations, consider the following three examples.[10] On September 19, 2001, the U.S. Equal Employment Opportunity Commission (EEOC) announced that a Florida jury had found Outback Steakhouse guilty of sex discrimination against a female employee and had ordered the company to pay the victim $2.2 million in damages. The employee held an administrative position, which she lost to a male employee after personally training him. When she complained, Outback transferred her to a clerical position. She later discovered that Outback had hired the male employee at twice her salary, so she complained again. This time Outback fired her.

On March 6, 2002, the EEOC reported that a federal court had approved a $1.245 million settlement of a class-action race discrimination lawsuit against McKesson Water Product Company and Groupe Danone (which acquired McKesson in 2002). The EEOC had accused McKesson of paying African-American drivers less and increasing their compensation at a slower rate than it did for white drivers. In addition to paying damages, McKesson agreed to implement new antidiscrimination policies, to train employees on equal opportunity law, to institute a formal job bidding system, and to develop new, nondiscriminatory criteria for determining route assignments, compensation, promotions, and performance evaluations.

On May 8, 2002, the EEOC announced a settlement with the Burlington Northern and Santa Fe Railway Company (BNSF) in a case involving the genetic testing of 36 employees. The employees were covered by the Americans with Disabilities Act and had not consented to the tests. The tests were implemented after the employees had filed claims for on-the-job injuries. BNSF agreed to pay up to a total of $2.2 million to the employees and to cease such testing. As employers are increasingly held accountable for their actions, we assume that they will work harder to create discrimination-free and harassment-free workplaces.

Working Conditions and Compensation

Several laws are designed to deal with working conditions and compensation. Table 11.4 gives a brief review of some of the more important laws in this area. Perhaps the best-known law in this area is the federal Occupational Safety and Health Act, passed in 1970 to reduce job-related accidents, injuries, and health problems by requiring all employers to institute preventive measures. The act created the *Occupational Health and Safety Administration (OSHA)* to be the watchdog over workplace safety issues. OSHA recently suggested safety measures, such as bulletproof glass partitions, to help protect retail clerks such as those in convenience stores. These workers, often victims of robberies, are in jobs that OSHA has found are among the most dangerous in the United States.

TABLE 11.4

Laws Dealing with Working Conditions and Compensation

Fair Labor Standards Act (1938)
- Established minimum wage.
- Guarantees employees overtime pay if they work more than 40 hours a week.

Occupational Safety and Health Act (1970)
- Designed to ensure safe and healthful working conditions.
- Created the Occupational Safety and Health Administration (OSHA) to conduct workplace inspections and protect workers against safety and health hazards.

Employee Retirement Income Security Act (ERISA) (1974)
- Established standards for business retirement, pension, and other employee benefit plans.

Family and Medical Leave Act (FMLA) (1993)
- Requires businesses with 50 or more employees to give unpaid leave for family and medical emergencies.
- Businesses must offer up to 12 weeks of unpaid leave after childbirth or adoption without loss of job seniority.
- Businesses must continue health care coverage during the leave.

A series of laws attempts to protect the financial security of workers. Perhaps best known is the Fair Labor Standards Act, which, among other things, established that employers must pay their workers a minimum wage and pay higher wages for overtime work.

In addition to these regulations, federal and state governments require businesses to share responsibility for dealing with certain potential social problems, such as injuries on the job, unemployment, medical care, and retirement. They require firms to make payments into funds that are used to help injured and unemployed workers, to provide for medical care, and to make monthly payments to retired workers and/or their dependents. From the standpoint of the business, such payments are part of the cost of employing each worker. These employment costs can be significant.

Unionization

In addition to the laws already listed, other important laws allow employees the right to join unions and bargain with employers. Some of the key laws in this area are covered in Table 11.5.

Employees usually join a union for one of three reasons. First, they may be dissatisfied with some aspect of their jobs, such as wages, benefits, or working conditions. Second, they may fear management. They feel the union gives them greater security and protection from arbitrary management actions. Finally, a union often represents employees who feel relatively powerless to deal with problems with the employer on their own. They hope the power and clout of the union will get management's attention.

collective bargaining The process through which company and union representatives work together to negotiate a labor agreement.

The law gives employees the right to form unions and to engage in **collective bargaining,** the process through which company and union representatives work together to negotiate a labor agreement. That agreement or contract covers many things, including terms of employment, how relationships between employees and the company will take place, and how grievances will be handled. The union represents employees in collective bargaining in exchange for dues the workers pay into the union fund.

TABLE 11.5
Laws Dealing with Employees' Rights to Unionize

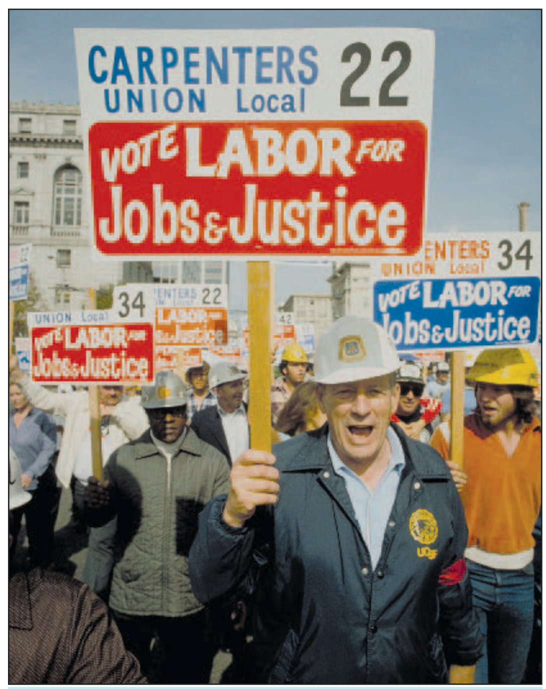
National Labor Relations Act (Wagner Act) (1935)
- Established the legal right of employees to join unions.
- Requires businesses to bargain collectively with unions representing their employees.
- Established the National Labor Relations Board (NLRB) to enforce the act.
- Prohibits unfair labor practices by employers.

Labor–Management Relations Act (Taft–Hartley Act) (1947)
- Prohibits unfair labor practices by unions.
- Lists the rights employees have as union members.
- Lists the rights of employers.
- Gives the president of the United States the right to temporarily stop a strike that will harm the national interest.

Labor–Management Reporting and Disclosure Act (Landrum–Griffin Act) (1959)
- Protects union members from abusive activities by their union.

Sometimes you will hear of a company and union engaged in collective bargaining but unable to reach an agreement. The collective bargaining process can break down, and unions can go on strike. This right to strike is protected by law. Although strikes get a lot of media attention when they occur, the vast majority of contract negotiations, over 95 percent, reach a settlement without a strike.

Labor–management relations are overseen by the *National Labor Relations Board (NLRB),* which was authorized by the National Labor Relations Act. The NLRB employs a staff of experts who investigate cases in which either a union or a company believes the other party has violated the contract. In most cases, it is the union that files an unfair labor practice case with the NLRB on behalf of a represented employee or group of employees. The NLRB also certifies elections conducted by employees who want to form a union for the first time.



Strikers create public attention and attempt to pressure the company into responding favorably to union demands. The Taft-Hartley Act allows the U.S. president to declare a "cooling off" period that temporarily stops a strike when national health and safety are threatened. What businesses or industries seem most likely to have this cooling off provision used?

Financial Regulation

When an American business attempts to raise financial resources, it runs into a variety of laws and regulations. Some make the process of acquiring capital easier or safer; others make it slower and more expensive.

One set of regulations deals with raising capital by issuing stocks or bonds. Before a business can offer stocks or bonds for sale, it must satisfy the legal requirements of federal and state security laws. Another set of regulations deals with financial reporting. Publicly traded American businesses are required to report information so that existing and potential investors in a firm's stocks and bonds can make informed decisions whether to sell or hold the securities. These reporting requirements and provisions are covered by the Federal Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities Exchange Act established the *Securities and Exchange Commission (SEC),* which oversees the trading of securities. Preparing such reports takes time, but they can be an important factor in potential investors' decisions to provide a business with capital funds. The availability of accurate financial information is one of the factors that make U.S. financial markets so strong.

When American companies enter the global market, operations become far more complex. Laws are different in other countries, so it is often difficult to deal with laws and customs in other countries without running afoul of U.S. regulations. A law that was passed to give structure to international business is the Foreign Corrupt Practices Act of 1977, which (among other things) prohibits the payment of bribes to foreign officials to get business.

Regulation of Consumer Relations

If consumers were all-knowing and all businesses were totally committed to providing full and accurate information, there would be little need for consumer legislation. Experience shows, however, that consumers do not always have adequate knowledge. Thus there are situations in which legal protection may be justified. Some regulations help ensure that consumers receive needed information about products and services they buy. Other regulations help ensure product safety. Still others guard against businesses using deceptive or unfair practices.

Table 11.6 identifies the major consumer protection laws in the United States. Each law has resulted in a plethora of government enforcement actions. To get a feel for what the business community experiences as a result of these laws, consider the following actions announced by the Consumer Product Safety Commission in June 2002.[12] The

TABLE 11.6

Key Consumer Protection Laws

Food, Drug and Cosmetics Act (1938) plus amendments

- Charge the Food and Drug Administration (FDA) to set and enforce standards for safety, purity, production cleanliness, efficacy, and labeling of drugs, cosmetics, and food products.

National Traffic and Motor Vehicle Safety Act (1966) and related acts

- Give the National Highway Traffic Safety Administration authority to set and enforce standards for motor vehicle safety and fuel economy.

Fair Packaging and Labeling Act (1966)

- Requires the manufacturer to clearly state the contents of a package in a prominent place and use a unit of measurement appropriate to the product.

Truth-in-Lending Act (part of the Consumer Credit Protection Act) (1968)

- Applies to consumer credit loans; requires the lender to disclose the amount of the finance charge and the annual percentage rate of interest.

Consumer Product Safety Act (1972)

- Gives the Consumer Product Safety Commission authority to set consumer product safety standards, ban hazardous consumer products, and require manufacturers to report defects and dangers in their products.

Brinkmann Corporation of Dallas, Texas, agreed to recall 45,000 outdoor tabletop propane heaters that emitted high levels of carbon monoxide. Graco Children's Products of Elverson, Pennsylvania, agreed to recall 152,000 toy tracks attached to children's activity centers. The tracks posed a choking hazard to young children. The CPSC publicized the availability of portable heaters with safety devices that reduced the danger of carbon monoxide poisoning. Luxo Corporation of Port Chester, New York, agreed to recall 18,300 portable fluorescent lamps that could overheat and cause a skin burn hazard to consumers. Peg Perego USA of Fort Wayne, Indiana, agreed to pay a $150,000 civil penalty to settle allegations that the company had failed to report serious defects in its battery-operated ride-on toys. The CPSC alleged that the defects posed both a fire hazard and an injury hazard due to failure to stop.

The government requires producers of food products to put labels on their products that list the ingredients as well as nutrition information, such as the amount of fat, sodium, cholesterol, and sugars. Why is this information important to consumers? Should it be required?

As you can see, these regulations really address the responsibilities that a business should logically have toward its customers, as discussed in Chapter 6. These topics are governed by state and federal legislation and enforced by agencies within the executive branch of the appropriate governments. With respect to federal laws, the Federal Trade Commission and the Consumer Product Safety Commission are the two most prominent agencies. Notice that in this area the government's role seems to be to force businesses to tell the truth, the whole truth, and nothing but the whole truth.

Another area of consumer protection, tort law, is governed by the state and federal court system. A **tort** is either intentional or negligent behavior that harms another person. Tort law makes businesses potentially liable for wrongfully harming a consumer. Under this law, the injured customer can sue the seller, and the settlements can be quite large.

tort
A behavior, either intentional or negligent, that harms another person.

Consumer protection is also provided by the agencies regulating specific industries. In the airline industry, for example, safety is regulated by the Federal Aviation Administration (FAA). The Federal Communications Commission (FCC) regulates the communications industry. The Nuclear Regulatory Commission (NRC) regulates power plants. Transportation is regulated by the Interstate Commerce Commission (ICC).

Regulation of Environmental Issues

By the 1960s, many parts of the United States suffered from air and water pollution. The problem became so serious that the government stepped in with regulations that reduced the pollution and raised the quality of the nation's air and water. Once the public became aware of government's ability to protect the environment, other environmental issues arose. Among those of greatest concern to business are the issues of solid waste disposal and the protection of endangered species. Some of the legislation designed to address environmental problems is shown in Table 11.7.

Three areas of environmental regulation—air pollution, water pollution, and toxic substances—affect substantial numbers of businesses. Federal regulation of air pollution began with the Clean Air Act of 1963, which set broad goals for cleanliness. Regulation was substantially toughened by the Clean Air Act Amendments of 1970, 1977, and 1990. Water pollution regulation received significant federal support with the Clean Water Act of 1977 followed by the Safe Drinking Water Act of 1986. Elimination of unregulated disposal of toxic substances was the target of the Toxic Substances Control Act of 1976.

TABLE 11.7

Key Environmental Laws

National Environmental Policy Act (NEPA) (1970)

- Requires that an environmental impact statement be prepared for business actions that could affect the environment.

Clean Air Act (1963, amended 1970, 1977, and 1990)

- Provides broad standards of air quality.

Resource Conservation and Recovery Act (RCRA) (1976) and Toxic Substances Control Act (1976)

- Regulates handling and disposal of hazardous waste.

Clean Water Act (formerly Water Pollution Control Act) (1977)

- Establishes goals and timetables to eliminate water pollution.
- Emphasizes control of toxic pollutants.

Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (1980)

- Creates superfund for environmental cleanup of hazardous waste.

Safe Drinking Water Act (1986)

- Regulates quality of drinking water.

Chemical Safety Information, Site Security, and Fuels Regulatory Relief Act (1999)

- Covers reporting of information regarding flammable fuels.

The Environmental Protection Agency (EPA) was created in 1970 to enforce the nation's environmental laws. The EPA is an active and far-reaching federal agency. For example, it has been involved in restricting the use of pesticides for many fruits and vegetables. Its primary focus of concern is children, who it fears may incur neurological disorders caused by pesticide exposure. Federal laws require business to incur the costs of reducing or eliminating the emission of contaminants that affect our air, water, and land.

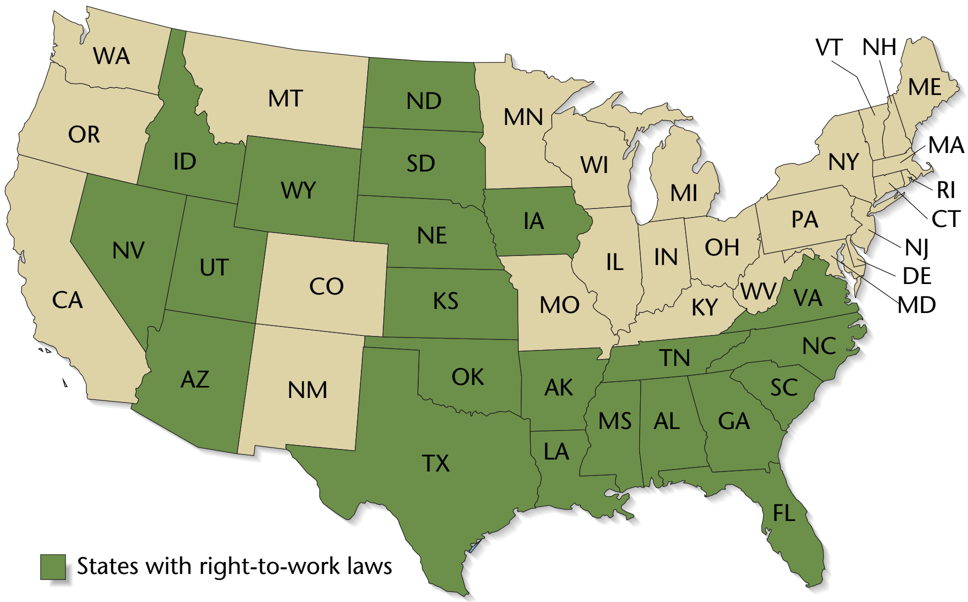
A representative example of the Environmental Protection Agency's enforcement efforts is the May 29, 2002, announcement of a settlement with Boston Sand and Gravel Company for a Clean Water Act violation. Boston Sand and Gravel was found to have discharged waste concrete material into the Millers River without a permit and to have discharged storm water into the Island End River and Mystic River without a permit. The Millers River pollution was alleged to pose a risk to wildlife and to the government goal of making the river swimmable by 2005. Boston Sand and Gravel agreed to pay a fine of $897,983 and to complete an additional environmental protection project which would cost the company $445,000.[13]

City, County, and State Regulations

There are many other regulations and restrictions that can affect businesses at the city, county, and state levels. Sometimes, state regulations are so severe that the company's managers consider moving to a more business-friendly state. Cities and counties have

FIGURE 11.1

States with Right-to-Work Laws



Source: "Right to Work States," National Right to Work Legal Defense Foundation website, www.nrtw.org (accessed September 28, 2002).

unique zoning laws that restrict where a business or one of its units can locate. Many cities and states require taxes of one form or another in addition to those collected by state and federal agencies. For example, a city might levy a 2 percent sales tax on restaurants and hotels to underwrite the building of a civic center complex.

A state regulation that affects many businesses has to do with unions. We said earlier that laws allow individual employees to join unions. However, 22 states and Guam have passed *right-to-work laws* that significantly restrict a union's ability to organize workers. These states are shown in Figure 11.1. Right-to-work laws state that it is against the law to force a worker to be a member of a union as a condition of employment. In other words, employees have the right to decide for themselves whether or not to join a union. Industrial states in the northern United States have traditionally not passed right-to-work legislation, preferring a stronger union presence in their manufacturing firms. Other states, especially in the South and West, have right-to-work legislation. As a result, the past two decades have seen a major migration of plants and entire businesses to the right-to-work states because companies that are not unionized can pay lower wages.

Although cities often make rules or establish taxes that discourage businesses, sometimes the opposite occurs. A large business considering moving into a city may be able to negotiate favorable concessions from the city government. This situation is especially likely to occur if the business intends to hire thousands of the city's residents. In fact, large companies considering building a new manufacturing plant often communicate their intentions to a number of cities. The cities (and sometimes even states) then compete to develop a favorable package, which may include tax relief, the construction of *infrastructure*—roads, sewer lines, and utilities—at no charge, and low-interest loans with favorable payback terms.

Taxes, Social Overhead Capital, and Subsidies

Taxes, like regulations, can be a source of irritation for businesses. Yet, like regulations, taxes often have a positive impact. Local, state, and federal governments use some of their tax revenue to provide goods and services that make it easier for businesses to function.

Some of those goods and services can be considered a form of capital investment that is made by government to increase the productive capacity of businesses. **Social overhead capital** is a term used to describe this form of government spending. Examples include roads and bridges, public education, police protection, and air traffic control service.

social overhead capital
The purchase of goods and services by government to increase the productive capacity of business.

In addition to social overhead capital, all three levels of government use some of their tax revenue to encourage business expansion or retention by providing subsidies of various types. An example of a subsidy is a city providing water and sewer service at no charge to a company that agrees to build a new factory in that town. Government research and development grants to businesses are another example. And, of course, some industries, such as those producing military equipment, earn most or all of their revenue by selling to the government.

Tax considerations are a necessary element of business planning. Investment decisions must take into account the tax laws and consider ways the investment can be made in a manner that legally reduces the taxes the firm will have to pay. Location decisions will often involve tax considerations. Lower taxes may be a reason for choosing one city, state, or even nation over another as the location for a new facility.

Global Competition and The Legal Environment

One of the major issues raised by the globalization of the U.S. economy is the differences between the legal environments in the United States and those in other countries. The basic question is whether or not government regulations in the United States make it overly difficult to compete. If they do, then the business may find it necessary to move production facilities to countries with less costly legal environments. The company's executives may agonize over such a decision because of the harm it may do to the American workers who will lose their jobs and the American communities that will lose a valuable taxpayer and community supporter. But in some cases, a failure to move could mean such a loss of competitiveness that the firm will go out of business. In other words, moving to a foreign location may be required for sheer survival.

There are two sides to this debate. One side argues that within limits, a tough legal environment can be a source of competitive advantage, not disadvantage.[14] Tough legal

THINK ABOUT THIS

1. Consider the following statement: Companies are supposed to compete aggressively, but if they are extremely successful, they must fear being regulated as a monopoly. How would you reconcile those two ideas?
2. Does antitrust policy really serve a useful purpose? If we did not have such a policy, wouldn't competition eventually break up any monopolies or price-fixing agreements that might develop?
3. Some people contend that government regulation itself is a problem. Think of some examples of how this belief could be true. Is the real problem government regulations or overzealous administration of them?

standards can produce a competitive advantage for two reasons. First, tough standards will force a firm to make continuous efforts to improve its operations to meet the standards. In the process, the continuous improvement habit will spread to other areas of the business. This outcome will give the firm a competitive advantage in terms of operating efficiency and a commitment to continuous improvement. Second, tough standards in one location often represent the standards that will eventually become the norm everywhere else. So the firm that learns to meet the standards early will have an advantage when firms everywhere have to meet them.

The other side of the debate suggests that countries with less costly legal standards will have an advantage when competing with countries that have more stringent restrictions.[15] Therefore, restrictions on international trade and other global rules can help ensure that companies worldwide compete on a level playing field. As suggested by Profile 11.4, global businesses themselves are beginning to push for global rules.

WHILE COUNTRIES DEBATE WORLD STANDARDS, COMPANIES WRITE THE RULES

PROFILE 11.4

The member countries of the World Trade Organization agree that continued expansion of world trade will require global rules regarding labor, environmental, and other social standards. But the member countries have not been able to agree on the actual rules.

In the meantime, some global corporations and their developing-country suppliers are taking the initiative to set some standards. By 2002, more than 240 codes of conduct regarding the environment and labor relations had been established voluntarily in the United States and Europe. Many were initiated by individual companies and represented no more than the companies' promises to abide by the rules they had set. But at least 26 codes involved associations of companies and required the members to allow independent inspection of their facilities. For example, clothing makers in Bangladesh agreed to a set of rules restricting the use of child labor, prohibiting forced labor, and guaranteeing the right to form labor unions. The agreement included a provision to have inspections conducted by the International Labor Organization.

Why the hurry? Constant pressures from consumer and human rights groups were certainly one factor. The possibility of obtaining higher U.S. import quotas was another. In addition, some business leaders saw self-imposed standards as a way of competing with lower-cost countries. Here is how the president of the Employers Confederation of the Philippines put it when explaining why 1,000 Philippine garment factories had agreed to abide by higher labor standards: "We want to make it clear in everyone's mind that if they buy Philippine products they know they're not made in a sweatshop."

Source: Aaron Bernstein, "Do-It-Yourself Labor Standards," *BusinessWeek,* November 19, 2001, pp. 74–76.

Business Ethics and the Legal Environment

It is important to end our review of the legal environment of business with a brief consideration of the relationship between ethics and the law. You have already encountered ethical issues in earlier chapters. Here we want to make you aware of the difference between law and ethics.

Lawful behavior represents the minimum standard of conduct that a society finds acceptable. Firms that fail to meet the minimum standards run the risk of being punished. Failure to meet legal standards may even lead to bankruptcy. Firms that fail to meet the minimum standards of the law may lose the trust of customers, employees, suppliers, and competitors.

However, the mere fact that some action is not legally required of the business or specifically prohibited by the law does not mean it is right or proper. A firm that is genuinely committed to high ethical standards may do more than the law requires. Sometimes that requires structuring the business so that management has the freedom to operate by high ethical standards. Sometimes maintaining a high standard of ethics leads to lower profits in the short run. Sometimes a firm may have to pull out of certain markets to abide by high standards of ethics.

Although ethics is a higher standard of behavior than the law, there is often a close relationship between the two. In a democratic society, laws represent the desires of the people. They map out a collective expression of what is proper and right for that society. Ethics, the search for what is proper and right, is the basis for law. Ethical concerns can lead to the development of laws; some laws that affect business are responses to alleged or real ethical shortcomings. For example, the National Traffic and Motor Vehicle Safety Act of 1966 was passed after the publication and widespread discussion of the book *Unsafe at any Speed,* written by consumer advocate Ralph Nader. Nader alleged that the carmakers produced cars that they knew were unsafe and decided not to take steps to reduce the possibility of serious injuries. The ethical discussions that surrounded this situation raised enough concerns that laws were enacted to prescribe adequate safety in automobiles.

In late 2002, a similar situation was developing with regard to ethics in the financial services industries. The failure of some highly visible firms to employ a publicly acceptable standard of business ethics led to a loud and widespread call for corrective legislation in 2002. Congress began hearings to consider such changes while, at the same time, some government agencies announced plans to issue new rules to force firms to behave better. This is an important public policy issue, and there clearly are opportunities for positive regulatory actions. But there is also the danger of overreacting. As *The Economist* put it in June 2002, "The biggest mistake would be to sacrifice the benefits of well-functioning capital markets. All the evidence is that deep and liquid capital markets constitute one of America's biggest competitive advantages."[16]

In summary, laws are a minimum foundation. Many businesspeople move beyond that foundation because they feel it is right and proper to do so. These actions, when collectively felt and expressed, can lead to changes in the law to reflect higher standards for all.

THE BIG PICTURE

The legal and regulatory environment affects every aspect of the business. Every aspect of business planning and operation requires legal knowledge. That means incurring costs of legal advice and compliance with the law. Large firms will usually have a legal staff to help them sort through the relevant laws and encourage legislation favorable to their operations. Small firms will seek outside legal assistance from time to time and support trade association efforts to pass favorable legislation. Both large and small firms will, if they are farsighted, bear the cost of training employees to be aware and observant of the laws affecting their operations. The wisest of firms will go the extra mile and instill a high standard of ethics.

While legal issues and regulations impose costs on businesses, they also provide benefits. Clear laws and consistent enforcement provide the best methods for ensuring a healthy environment where businesses, consumers, and society all emerge as winners.

Summary

1. Human institutions are based on assumptions regarding the way the world works, or at least ought to work. If the institutions are going to work effectively, the people working in them and with them must understand and accept this underlying philosophy.
   - What are some of the basic philosophical concepts underlying the legal environment of a capitalistic society?

   This chapter identified four crucial concepts: (1) freedom, (2) property rights, (3) risk taking, and (4) responsibility.

   Freedom is the power to make one's own decisions or choices without interference from others.

   Property rights are the freedom to possess and regulate the use of tangible items such as land and buildings and intangible items such as a copyrighted piece of music.

   Risk taking means that businesses (and individuals) are willing to undertake actions without knowing what the results will be.

   Responsibility in the business context refers to using property in a manner that does not unduly infringe on the freedom of others.
2. A healthy capitalistic economic system requires a government that not only regulates business but also encourages business investment and risk taking.
   - What are some of the ways government supports business?

   This chapter identified five ways government encourages business: (1) limiting ownership liability; (2) limiting losses through bankruptcy laws; (3) protecting innovation through copyrights, trademarks, and patents; (4) providing structure through rules and industry standards; and (5) encouraging competition by limiting monopoly power.
3. Most businesses can be counted on to act responsibly most of the time. But there will always be glaring exceptions. And even many basically honorable managers may from time to time be tempted or pressured to engage in socially irresponsible behavior. Consequently, governments in all capitalistic economies find it necessary to regulate business in a variety of ways.

- What are some of the major ways government regulates business?

This chapter identified the following seven forms of government regulation: (1) regulation of monopoly; (2) regulation and deregulation of industry; (3) regulation of employee relations; (4) financial regulation; (5) regulation of consumer relations; (6) regulation of environmental issues; and (7) city, county, and state regulations.

4. All businesses pay taxes to the government.
   - What are some of the benefits that government provides to business in return?

   This chapter identified two benefits. One is social overhead capital, which consists of such capital investments as roads and education. The second is direct subsidies used to encourage business expansion or retention.
5. All nations engage in government regulation of business, but the regulations differ from one country to another. This situation creates a potential problem for firms involved in global competition.
   - What is the basic conflict that can emerge between global competition and a nation's system of business regulation?

   The basic conflict is that some of the nation's business regulations and taxes may make it difficult for domestic firms to compete in a global economy. If the regulations raise the cost of doing business in the home country, the domestic government may be under pressure to relax its regulations in order to lower the costs of doing business and thereby improve the competitiveness of domestic firms.
6. If all businesses operated on a high ethical plane all the time, there would be no need for many existing government regulations.
   - What is the relationship between business ethics and the law?

   Laws represent the minimum standard of behavior a business should maintain. A firm that is genuinely committed to operating by a high ethical standard will do more than the law requires.

Key Terms

antitrust laws, p. 276
bankruptcy, p. 272
collective bargaining, p. 282
copyright, p. 272
freedom, p. 270
industrywide regulation, p. 278
monopolization, p. 277
patent, p. 272
price-fixing, p. 277
property rights, p. 270
responsibility, p. 271
risk taking, p. 271
social overhead capital, p. 288
tort, p. 285
trademark, p. 272

Exercises and Applications

1. Form teams. Half of the teams will take the view that government regulation is basically helpful to business. The other half will take the view that government regulation is overly restrictive. Outline your arguments and be ready to present your case to the class.
2. Check out the website for the U.S. Patent Office (www.patent.gov). What is required to get a patent? Now do the same thing for trademarks and copyrights. What are the differences? Write your results in a one-page report.

3. Interview a local business owner about the specific government regulations that she or he encounters. Pick one issue of law noted by the owner. Look up information on the law and decide whether the stated purpose of the law and its value outweighed the cost and inconvenience to the owner.
4. Prepare to debate the following statement: Local and state regulations are more troublesome for most businesses than are federal regulations.
5. Can there ever be a situation in which a business or a business manager behaves ethically but illegally? Explain.

Southern: The New Power in Power

FROM THE PAGES OF BusinessWeek

Companies can and do try to influence the rules of the legal environment in which they operate. Take the lobbying efforts of the electric utility Southern Company. "In recent years, Southern Co.'s strategy in Washington hasn't been terribly different from that of other successful corporations: lavish millions on politicians and hire a battery of A-list lobbyists to make sure its voice was heard in the corridors of power. Trouble was, as hard as it tried, the Atlanta-based utility giant kept running into fierce resistance from a colossus named Enron Corp., whose views on energy deregulation and other issues were diametrically opposed to Southern's agenda." Southern wanted to keep government regulation of electricity. Enron was the nation's premiere promoter of deregulation.

"Now, with Enron having collapsed in scandal, Southern is emerging as the new power in power: And the company that provides electricity to 4 million customers in the Southeast intends to use that clout to win concessions as Congress completes action on an energy package and clean-air legislation . . . The utility's seven political action committees have [already] spent more than $1 million since 1999 . . . Southern's lobbying activities don't stop at the federal level. In its four states, Southern, its affiliates, and its employees donated $116,430 to candidates in the latest elections.

"What is Southern getting for its money? At the state level it has staved off deregulation. And on White House policies from energy to air pollution, the utility has found a sympathetic ear.

"The influence of Southern . . . will be tested again in coming weeks as the energy debate heats up. Legislation nearing completion on Capitol Hill includes several measures pushed by Southern, such as research and development funding for clean-coal technologies. In addition, the House version provides $3.3 billion in tax credits over 10 years for clean-coal investment and production—another item on Southern's wish list."

Decision Questions

1. This case illustrates the fact that different groups of businesses mount opposing lobbying efforts. Can you think of other groups of businesses that would be likely to disagree regarding laws affecting their legal environments?
2. This case illustrates some of the ways the legal environment affects a business. Name them. Can you think of others that might affect an electric utility company?
3. This case reminds us that our elected officials receive financial support from businesses and that businesses expect something in return. Do you consider this relationship a problem? Should contributions from business be made illegal?

Source: Laura Cohn, "Southern: The New Power in Power," *BusinessWeek,* June 3, 2002, pp. 62–63.

References

1. "Fortune 500 Largest Corporations," *Fortune,* April 15, 2002, pp. F-1 to F-20; "The 100 Best Companies to Work For," *Fortune,* February 4, 2002, pp. 72–90; and Matthew Boyle, "The Shiniest Reputation in Tarnished Times," *Fortune,* March 4, 2002, pp. 70–72.
2. Jay Greene, Steve Hamm, and Jim Kerstetter, "Balmer's Microsoft," *BusinessWeek,* June 17, 2002, pp. 66–74; Mike France and Jay Greene, "Commentary: Settlement or Sellout?" *BusinessWeek Online,* November 19, 2001 (accessed October 1, 2002); Rebecca Buckman and Gary McWilliams, "Microsoft Adjusts Windows' Features," *The Wall Street Journal,* May 24, 2002, p. A3; and "Microsoft," *Value Line Investment Survey,* May 31, 2002, p. 2200.
3. "Kmart," *Value Line Investment Survey,* May 17, 2002, p. 1682; and "Kmart Trustee Plans Shareholders Panel," *The Wall Street Journal,* May 29, 2002, p. A2.
4. For additional information on patents and trademarks, see the United States Patent and Trademark Office website www.uspto.gov. For information on copyrights, go to www.copyright.gov.
5. Amy Barrett, "Merck Could Use a Few Pep Pills," *BusinessWeek,* December 17, 2001, pp. 128–29.
6. Kevin Freiberg and Jackie Freiberg, *Nuts! Southwest Airlines' Crazy Recipe for Business and Personal Success* (Austin, TX: Bard Press, 1996), pp. 17–18.
7. Ibid. pp. 20–25.
8. Nancy Millman, "$100 Million Fine in ADM Guilty Plea," *Chicago Tribune,* October 15, 1996, sec. 1, pp. 1, 14.
9. Scott Kilman, "Court Reinstates Suit Alleging Archer Rigged Sweetener Market," *The Wall Street Journal,* June 19, 2002, p. D2.
10. These are three of a number of cases reported in the press release section of the EEOC website in June 2002, www.eeoc.gov/press (accessed June 5, 2002).
11. Randall Smith and Aaron Lucchetti, "How Spitzer Pact Will Affect Wall Street," *The Wall Street Journal,* May 22, 2002, p. C1.
12. These examples come from the U.S. Consumer Product Safety Commission's website, www.cpsc.gov/cpscpub/prerel/prerel/junos (accessed June 16, 2002).
13. "EPA and U.S. Attorney Announce $1.3 Million Enforcement Settlement for Clean Water Act Violations," *EPA New England Press Releases,* May 29, 2002 (accessed through the EPA website, www.epa.gov/region1/pr2002, June 17, 2002).
14. Michael E. Porter, *The Competitive Advantage of Nations* (New York: Simon and Schuster, 1989).
15. John Cobb and Herman Daly, *For the Common Good* (Boston: Beacon Press, 1989).
16. "The Wickedness of Wall Street," *The Economist,* June 8, 2002, p. 12.