BEYOND-COMPLIANCE AS A STANDARD: A MARKET FAILURES APPROACH TO BUSINESS ETHICS FOR SMALL BUSINESS GOVERNMENT CONTRACTORS

A Thesis submitted to the Faculty of
The School of Continuing studies
and of
The Graduate School of Arts and Sciences
in partial fulfillment of the requirements for the degree of
Doctor of Liberal Studies

By

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Washington, D.C.
March 15, 2016
ABSTRACT

The federal acquisition process has undergone significant scrutiny and has found itself in the center of a sea change of reform demanding higher standards of ethics and integrity from government contractors in an effort to promote fair competition. The recent changes to the Federal Acquisition Regulation (FAR) have incorporated stringent ethics requirements that reflect the government’s resolve to rein in contractors and reinforce the long-established policy requiring the government to conduct business only with contractors having a “satisfactory record of business ethics and integrity.” One such change is the amendment to incorporate FAR Clause 52.203-13, which mandates the establishment of rigorous ethics requirements such as ethics programs, internal control systems, ethics training for contractor employees, and a code of business conduct.

The government elected to exempt small-business contractors from the more stringent ethics requirements due to the financial burden associated with compliance. The intent may have been honorable; however, the imposition of only minimal ethics requirements in an environment where the government is
aggressively demanding higher ethics and integrity standards for contractors will likely place small-business government contractors at risk of non-compliance and possible debarment or suspension. Small business contractors can mitigate risks by implementing a beyond-compliance approach to align their business objectives with those of the government’s ethics agenda.

This paper specifically focuses on the requirement for small-business, government contractors to establish a code of conduct and promote compliance with the code throughout the organization. The text argues that the ethics requirements are only in effect during the performance period of a specific contract; therefore, the code to be created must address the procurement-related transactions between government and contractor, in other words, market transactions. Rather than designing a code irrelevant to the government’s objectives, the contractor should devise a code that complies with both the spirit and letter of the regulation.

The paper analyzes both shareholder and stakeholder theories as the basis of a normative ethics to determine their suitability to underpin a compliant code. It then explores the Market Failures Approach to business ethics as espoused by Joseph Heath. This method quickly rises to a position of primacy.
ACKNOWLEDGMENTS

There are so many persons to whom I am grateful for their support and steadfast confidence that fueled my motivation to successfully complete this long and sometimes arduous journey. I thank my entire family, friends, and loved ones, who supported me in so many ways.

I specifically thank my beloved husband, George Jackson, for his support, understanding, unwavering commitment, and willingness to tolerate a spouse who was often preoccupied with books, papers, theories, or meetings associated with “The Project.” I thank him for always going above and beyond on my behalf.

I also thank my Mother and late Father, Hattie and Robert Nichols, for inspiring me to strive for excellence in all that I do, and for teaching me that I really can do all things through Christ who gives me strength. I love you Mom.

I must acknowledge the late Phyllis O’Callaghan, Ph.D., and others who worked selflessly to bring the vision of a DLS program to fruition at Georgetown. During my interview for admittance, I told her that I was tenacious and had no doubt I would successfully complete this program. I am elated that I have made good on that promise.

I would like to thank Peter Jaworski, Ph.D., for agreeing to serve as my thesis chair and for providing excellent guidance and support throughout this process. I thank him for the wealth of knowledge that he eagerly shared, which
exposed me to innovative methodologies and concepts that served to shed new perspectives on business ethics. It was indeed a pleasure and honor to work with him.

I offer my deepest gratitude to Professors Francis J. Ambrosio, Ph.D., Terrence P. Reynolds, Ph.D., Douglas M. McCabe, Ph.D., and William P. McDonald, Ph.D. I cannot thank them enough for educating and inspiring me through the coursework, invigorating debates, and discussions within a stimulating academic setting. Words are inadequate to articulate the extent to which this has enriched my life. I am also indebted to them for actively taking part in my preparation for completing this last phase of the program. I appreciate the kindness, guidance, patience, and willingness to assist over the years.

I thank Ann Ridder for all of her support during my participation in the program. She is a marvelous person and valuable resource, who is always so gracious and willing to provide assistance, guidance, and advice whenever needed.

Finally, I must acknowledge my Lord and Savior, Jesus Christ, for granting me this opportunity and providing the wherewithal to make it to the end. I never could have made it without his amazing grace.
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CHAPTER 1

INTRODUCTION

Over the past two decades there has been a rash of scandals surrounding egregious corporate misconduct such as fraud, financial misdealing, involvement in conspiracies to conceal profits, stealing through corruption, and lying. The media has played a tremendous role in raising public awareness of the significant schemes of corporate corruption, and the Government has responded with legislation such as the Sarbanes-Oxley Act (SOX), as well as amendments to the U.S. Sentencing Guideline, geared towards holding companies accountable for criminal conduct associated with the organization. New legislation also called for the establishment and maintenance of formal Organizational Ethics and Compliance Programs with dedicated, high-level resources to oversee the implementation and to administer the programs.

The momentum continues today. In October of 2013 the House of Representatives passed a bill entitled the “Stop Unworthy Spending (SUSPEND) Act,” whose purpose is to consolidate the 41 suspension and debarment systems that are administered at the agency level into one centralized, effective and efficient system that General Services Administration will administer. In that same year, the Small Business Administration published a final rule requiring large government contractors to make good on promises to small businesses via
teaming agreements to the fullest extent possible or face stiff penalties and an unfavorable entry into the Federal Awardees Performance and Integrity Information System.

The federal acquisition process has also undergone significant scrutiny and has found itself in the center of a sea change of reform demanding higher standards of ethics and integrity from government contractors. Recent changes to the Federal Acquisition Regulation (FAR), which governs the procurement process for substantially all the executive branch agencies, reflect the government’s resolve to rein in contractors and reinforce the long-established policy requiring the government to conduct business only with contractors having a “satisfactory record of business ethics and integrity” (Federal Acquisition Regulation, 2015). In 2007 and 2008, the FAR was amended to raise the ethics bar for contractors by incorporating rigorous requirements for the establishment of an ethics program, internal control system, and ethics training for employees. Further, the FAR expanded the scope of activities that could lead to debarment or suspension from conducting business with the government.

Out of consideration for their limited resources and the high cost of compliance, the government exempted small businesses from most of the ethics-awareness requirements. The new FAR clause 52.203-13 only requires small
businesses (generally defined as entities with less than 500 employees\(^1\)) to:
develop a written code of ethics for dissemination to contract employees; disclose
any detected criminal activity associated with the procurement in a timely
manner; and otherwise promote a culture that encourages ethical conduct and
commitment to compliance with the law.

At first glance one might intuit that the requirements for small businesses
are easily achievable, but further scrutiny reveals some unsettling ambiguities.
Disclosing criminal activity is not an issue because of the associated legal
obligation that the company must fulfill. The purpose of that requirement is clear.
However, the intent of the other requirements—develop a code of conduct and use
that code as the basis for promoting an ethical culture— is ambiguous. What kind
of code of ethics does it take to comply? Which topics should the code address?
Will any code do? What happens if the code is insufficient? These are the types of
concerns that haunt the small-business community because the government is
reluctant to provide any guidance on the structure and content of the code. As seen
later in the research discussion, companies often apply a broad interpretation of
business ethics to include security issues, quality and professional certification
requirements, in addition to traditional topics like employee conduct,
confidentiality, conflict of interest, fraud, and discrimination, to name a few. Would
\(^1\) The Small Business Administration’s Office of Small Business Advocacy defines small
business based on number of employees on its website www.sba.gov/advo under Frequently Asked
Questions. Site updated January 2011.
a code based purely on quality standards (e.g.; Lean Six Sigma, CMMI, ISO) or security requirements render compliance? The government clearly states that it will not review the code unless a problem arises. What happens if a problem does arise but it is not covered in the code of ethics?

In the quest for answers, one need only look to the spirit of the new rule and the government’s ethics agenda. The ethics requirements apply to procurement-related activities only, and the intent is to increase contractor accountability and promote fair competition. The government is not concerned with internal relationships and interactions. The rule focuses solely on the ethics that govern the dealings between the contractor and government—the market transactions. It stands to reason that a compliant code of conduct would be one that addresses market transactions, thus conforming to the spirit of the law.

In an environment where the government is mandating higher ethical standards for its industry partners and suspension and debarment activity is on the rise, small-business government contractors are at great risk and must find strategic means to mitigate those risks. The solution is for small businesses to align their corporate objectives with the ethics objectives of the government and implement the necessary measures to realize those objectives. This requires the application of a beyond-compliance approach. Adopting and promoting compliance with a code of conduct that is based on a market failures approach,
which addresses market transactions, aligns well with the framework of the FAR and is a first step in achieving this goal.

It is the purpose of this project to present a market failures approach to business ethics for small government contractors, using the Contractor Code of Business Ethics and Conduct requirements within the FAR as the overall framework to ensure compliance. The small business sector, which includes small government contractors, is a major contributor to the U.S. economy and society as a whole. According to the Small Business Administration (SBA) Office of Advocacy, small firms employ nearly half of all private sector employees (49.2%); pay 42.9% of total U.S. private payroll; and have generated about 64% of net new jobs over the past 18 years. (Small Business Administration Office of Advocacy 2012) Small-business government contractors alone received $97.9 billion in government contracts in FY2010 and $91.5 billion in FY 2011. (Small Business Administration 2012) As such, the project’s intent is to mitigate the risk of suspension and debarment within this valuable group by advocating beyond-compliance to ensure government contractors stay in sync with the government’s ethics agenda and maintain compliance with the FAR.

The structure of this text consists of five chapters. Chapter 2 provides background on the FAR, its history, structure, and amendment process. It specifically addresses FAR clause 52.203-13, Contractor Code of Business Ethics
and Conduct. Chapter 3 discusses alternative approaches to business ethics and demonstrates the market failures approach's position of primacy as the methodology best suited to achieve compliance with FAR ethics requirements. Chapter 4 presents the results and implications of the research study, which comprises both an Internet survey and focus group discussion. Chapter 5 concludes.
CHAPTER 2

THE FEDERAL ACQUISITION REGULATION

The U.S. Government is the largest purchaser of goods and services in the world; and the Department of Defense (DOD) is the largest buyer among all U.S. departments. In fiscal year 2014, the U.S. Government spent $445.6 billion in contracting a wide range of goods and services across the varying organizational components of the Executive Branch Agencies (U.S. Treasury Bureau of the Fiscal Service 2015). The Federal Acquisition Regulation (FAR) provides the requisite framework to facilitate the government’s procurement transactions by addressing every aspect of the full procurement lifecycle—acquisition planning to contract formation to contract management. The FAR, which is codified in the U.S. Code of Federal Regulations (CFR) at Title 48, parts 1-53, is an acquisition system that comprises the regulations, policies, procedures and processes for the procurement of goods and services for most executive branch agencies, to include executive departments, military departments, independent establishments and wholly-owned government corporations (FAR 48 C.F.R. §2.101(b)). There are certain executive agency components that are not subject to the FAR, such as the Federal Aviation Administration and the U.S. Mint.

The creation of the FAR was a response to the need to centralize disparate procurement practices that were pervasive across government agencies, in an
effort to increase efficiency, reliability, standardization, and integrity of procurement activities. The overall vision of the FAR is to provide the government customer with timely delivery of quality goods and services, while “maintaining the public trust and fulfilling public policy objectives” (Manuel, Halchin, et al. 2012, 9). The realization of this vision, however, has been an ongoing challenge resulting in numerous amendments to the FAR over time, directing not only government procurement policies and procedures, but also contractor processes including internal management and operations. The amendment to incorporate FAR clause 52.203-13, Contractor Code of Business Ethics and Conduct, is a prime example of government policy with an extended reach into the internal operations of private industry, as discussed later in this chapter.

**Government Procurement Prior to the FAR**

In order to understand the state of government procurement practices prior to the establishment of the FAR, it is necessary to highlight three critical factors that perpetuated the existence of an inefficient, antiquated, and ailing acquisition system—(1) excessive regulation, (2) strained government-contractor relations, and (3) preference for favoritism rather than competition.

*Excessive Regulation*

Prior to the FAR, there existed a plethora of directives, regulations, and laws installed to address complex issues associated with mounting procurement
transactions. Agencies, sub-agencies, and departments alike created their own procurement regulations designed to meet agency-specific needs. This lack of coordination of effort resulted in the proliferation of disparate, conflicting, and often redundant regulations across the entire federal government. In the late 1960s, Congress established the Commission on Government Procurement, whose main purpose was to develop and recommend basic improvement to the existing, inefficient system. One of the major goals was to streamline regulations. During its assessment, “the Procurement Commission encountered a mass of rules and regulations within the procuring agencies that were difficult to understand and subject to little or no check on proliferation at lower organizational levels. Gaps and inconsistencies abounded” (U.S. Comptroller General 1979, i). Further, it found a “burdensome mass of procurement regulations within individual Federal agencies and little or no system to coordinate and control the regulations” (U.S. Comptroller General 1979, 7).

Additional studies ensued to determine the extent of this proliferation of regulations. The Office of Federal Procurement Policy conducted a study of 19 government agencies during the 1978 to 1979 time frame where it discovered "877 different sets of procurement regulations, including directives, bulletins, and instructions, comprising 64,600 pages of regulations (nearly one-half in DOD), 29,900 pages of which were promulgated or revised annually" (Nagel 2012, 150).
The findings also revealed that organizations below the headquarter level were responsible for producing the vast majority (83%) of these regulations (Nagel 2012, 150). As a result, the procurement process was cumbersome and inefficient, requiring contracting personnel to consult voluminous sources to ensure compliance with the tenets of the various regulations.

In addition to creating inefficiencies within the federal acquisition process, excessive regulation, coupled with the absence of a centralized system, resulted in a procurement imbroglio that stymied the development and sustainment of a qualified acquisition workforce to administer procurement activities. “The explosive growth of procurement regulations 'literally suffocated' the discretion of contracting officers, because they were told in minute detail how to perform their duties” (Nagel 2012, 151). In fact, it was commonplace for a DOD contracting officer to have to consult massive volumes of documents when seeking guidance on performing procurement activities within the limitations of his or her authority. Therefore, there was great concern that the web of regulation was eroding the autonomy of the once-prestigious role of the contracting officer, making it difficult to recruit and retain the interest of qualified professionals. In *A History of Government Contracting*, James Nagel quotes the sentiment of Commissioner James T. Ramey, who served as head of the Atomic Energy Commission from 1962 to 1973, regarding this dilemma. He writes, “If you have a system of contracting or
administrating where everything is written out on what a fellow should do, and there isn’t any room for judgment or discretion . . . over a period of time, you don’t tend to get good people that are doing your administration or carrying out your contracts” (Ramey n.d.).

**Strained Government – Contractor Relations**

The proliferation of procurement regulation affected not only government acquisition personnel, but the entire government contractor community as well. As regulations continued to mount, there was an increase in the number and type of restrictive clauses and conditions incorporated into contracts that affected vendor operations. For example, there was language that allowed the government to make demands on the contractor’s operational and managerial activities, such as interacting with employees and determining cost data. Further, it became standard practice to incorporate clauses that would shift much of the contracting risk to the contractors. These maneuvers fostered an environment of distrust and created a strain in the relationship between contractor and government. Nagel, for instance, suggests that one of the top concerns was the extent to which government intervened in the way contractors did their work. He states, “Contractors particularly despised how the government now intruded on their inner workings” (Nagel 2012, 152). This produced more of an adversarial relationship rather than a cooperative partnership between the two parties. The contract had become a
“contract of adhesion,” reflecting a power relationship, not a consensual agreement” (Nagel 2012, 153).

As the government-contracting environment became more antagonistic and riskier to industry, a significant number of businesses began to shift their focus from government to commercial contracting with the goal of capturing more lucrative and less restrictive opportunities. Many contractors who continued to support government programs did so out of necessity more than anything else. These firms had already invested in the requisite infrastructure to support their predominantly government line of business; therefore, changing their business model capriciously was not a viable option. As such, their only alternative was to adapt to the rules and comply with all the regulations, albeit begrudgingly.

Preference for Favoritism rather than Competition

During the 1980’s, the awarding of federal contracts on a non-competitive basis was common practice among acquisition professionals and appeared to be the method of choice to procure goods and services, despite the requirement for full and open competition. “In 1982, only 37% of government contract dollars were awarded competitively across the entire federal government; —out of $146.9 billion in contracts in excess of $10,000, only $54.5 billion were awarded competitively" (Tansey 1984). This trend towards circumventing competition led to the proliferation of fraud, waste, and abuse throughout the federal government.
There were numerous accounts of scandals involving the sale of lucrative contracts to ‘well-connected’ contractors in exchange for material items or favors. Further, there were accounts of the government paying overly inflated prices, such as “procurements of $400 hammers, $700 toilet seats, $2,000 pliers, and $9,000 wrenches… The Pentagon was paying $18 for a $.67 bulb and five hundred percent markups on aircraft engine parts” (Nagel 2012, 160). It was clear that the absence of the competition mechanism fostered an environment conducive to fraud and waste. What was unclear, however, was how to curtail the escalation of these improprieties that were costing the government money and eroding the confidence of the American people.

**Establishment of the FAR**

It was the rapid expansion of government contracting activity over the past 40 years that necessitated the development and implementation of a robust acquisition regulation system capable of standardizing and controlling regulation across the federal government. In 1974, Congress created the Office of Federal Procurement Policy (OFPP) within the Office of Management and Budget (OMB) to oversee the Procurement Reform Program. One of its primary functions was to review and assess recommendations for a unified procurement solution. In so doing, OFPP reviewed numerous recommendations set forth by the Procurement Commission over the course of several years, and in 1978, it ultimately settled on
adopting an entirely new centralized system called the Federal Acquisition
Regulation (FAR). The primary goals of this new regulatory framework were to:

1. Consolidate existing defense and civilian agency regulations.
2. Limit the occasion or need for additional agency rules.
3. Encourage public participation.
4. Put regulations in language understandable to all. (U.S. Comptroller
   General 1979, ii)

In 1979, Congress enacted legislation amending the Office of Federal
Procurement Policy Act (P.L. 93-400), thus authorizing OFPP to “issue policy
directives . . . for the purpose of promoting the development and implementation
of the uniform procurement system” (Manuel, Halchin, et al. 2012, 10). The FAR,
which was promulgated September 19, 1983, became effective October 1, 1984.

Structure of the FAR System

The Federal Acquisition Regulation System comprises the Federal
Acquisition Regulation, the primary document, and all agency-level acquisition
policies and regulations that implement or supplement the FAR. The development
of the FAR system conforms to the requirements of the Office of Federal
Procurement Policy Act of 1974, as amended by Public Law 96-83.

The Federal Acquisition Regulatory Council (FAR Council), established by
OFPP Act Amendments of 1988, consists of the Secretary of Defense and the
Administrators of the National Aeronautics and Space Administration (NASA),
General Services Administration (GSA), and OFPP; its primary responsibility is
oversight of the FAR. In establishing the Council, Title 41, Section 1302(a) of the U.S. Code (U.S.C) indicates its function is, “to assist in the direction and coordination of Government-wide procurement policy and Government-wide procurement regulatory activities in the Federal Government.” Additionally, its role is to “manage, coordinate, control, and monitor the maintenance of, issuance of, and changes in, the FAR” (Manuel, Halchin, et al. 2012, 12). The Administrator of OFPP serves as chair of the Council. To facilitate maintenance of this massive piece of legislation, the Council creates FAR Teams, comprised of personnel from military, civilian agencies and OFPP, who are responsible for specific parts of the FAR. Their primary function is to draft amendments that affect their designated areas of responsibility.

The FAR authorizes two agency-level councils – The Defense Acquisition Regulations Council (DARC) and the Civilian Agency Acquisition Council (CAAC) – whose principal function is the development and review of proposed changes to the FAR. Members of the two councils, which include senior procurement professionals within the Department of Defense (DoD) and designated executive branch agencies, work collaboratively to promote cooperation between employees from the defense and civilian sectors.
Structure of the Primary Document

The FAR provides the government a wide range of information, including the processes and procedures for performing specific acquisition-related functions. "The opening sections of the FAR articulate ‘guiding principles’ for the federal acquisition system that arguably inform all other sections of the FAR and federal procurement generally (e.g., satisfying the customer, minimizing administrative operating costs)” (Manuel, Halchin, et al. 2012, 6). The FAR contains 53 parts that address specific aspects of the acquisition process, as well as the definition of contracting terms and “general standards” that contracting personnel are to consider in making certain determinations. For example, Part 9, entitled “Contractor Qualifications” articulates the general standards for determining the extent to which contractors, or potential contractors, are responsible entities, as well as the methods contracting officers may employ to validate contractor qualifications and integrity (e.g., Federal Awardee Performance and Integrity Information System (FAPIIS), pre-award audits). Table 2.1 (Chapter 2, table 1) details the 53 parts that constitute the FAR.

Table 2.1. General structure of the Federal Acquisition Regulation document

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Part 33-Protests, Disputes, and Appeals |
|--------------------------------------------------|--------------------------------------------------|
| Part 5-Publicizing Contract Actions  
Part 6-Competition Requirements  
Part 7-Acquisition Planning  
Part 8-Required Sources of Supplies and Services  
Part 9-Contractor Qualifications  
Part 10-Market Research  
Part 11-Describing Agency Needs  
Part 12-Acquisition of Commercial Items | Part 34-Major System Acquisition  
Part 35-Research and Development Contracting  
Part 36-Construction and Architect-Engineer Contracts  
Part 37-Service Contracting  
Part 38-Federal Supply Schedule Contracting  
Part 39-Acquisition of Information Technology  
Part 40-Reserved  
Part 41-Acquisition of Utility Services |
| Subchapter C-Contracting Methods and Contract Types | Subchapter F-Special Categories of Contracting |
| Part 13-Simplified Acquisition Procedures  
Part 14-Sealed Bidding  
Part 15-Contracting by Negotiation  
Part 16-Types of Contracts  
Part 17-Special Contracting Methods  
Part 18-Emergency Acquisitions | Part 34-Major System Acquisition  
Part 35-Research and Development Contracting  
Part 36-Construction and Architect-Engineer Contracts  
Part 37-Service Contracting  
Part 38-Federal Supply Schedule Contracting  
Part 39-Acquisition of Information Technology  
Part 40-Reserved  
Part 41-Acquisition of Utility Services |
| Subchapter D-Socioeconomic Programs | Subchapter G-Contract Management |
| Part 19-Small Business Programs  
Part 20-Reserved  
Part 21-Reserved  
Part 23-Environment, Energy and Water Efficiency, Renewable Energy Technologies, Occupational Safety, and Drug-Free Workplace  
Part 24-Protection of Privacy and Freedom of Information  
Part 25-Foreign Acquisition  
Part 26-Other Socioeconomic Programs | Part 42-Contract Administration and Audit Services  
Part 43-Contract Modifications  
Part 44-Subcontracting Policies and Procedures  
Part 45-Government Property  
Part 46-Quality Assurance  
Part 47-Transportation  
Part 48-Value Engineering  
Part 49-Termination of Contracts  
Part 50-Extraordinary Contractual Actions and the Safety Act  
Part 51-Use of Government Sources by Contractors |
| Subchapter H-Clauses and Forms |  |
| Part 52-Solicitation Provisions and Contract Clauses  
Part 53-Forms |  |

**Source:** Data from U.S. Code of Federal Regulations Title 48, 1 Federal Acquisition Regulation 2016.

Parts 1 through 51 provide acquisition personnel the necessary policies, requirements, procedures and exceptions to empower them to accomplish their mission, which aligns with the overall vision of the FAR system. Parts 52 and 53 provide the standard components that will be incorporated into a solicitation or an awarded contract. For example, “Part 52 contains solicitation provisions and
contract clauses prescribed elsewhere in the FAR. Each provision and clause has
its own unique identification number” (Manuel, Halchin, et al. 2012). The
contracting official determines the applicability of a given clause to a specific
contract and then includes that clause or incorporates it by reference. Part 53
provides the agency with all forms to be used during the acquisition process.

The FAR explicitly authorizes agency heads to issue agency-specific
acquisition regulations to implement or supplement the FAR. “Agency-specific
regulations may only be issued when necessary to implement FAR policies and
procedures, or to supplement the FAR to meet the agency's specific needs. The
regulations may not conflict or be inconsistent with the FAR, except as required by
law or if the agency has used an authorized deviation (Manuel, Halchin, et al.
2012). The U.S. Code of Federal Regulations codifies these “agency supplements” at
Title 48, directly following the FAR.

Amendment Process

The FAR Council, by statute, is required to, “manage, coordinate, control,
and monitor the maintenance of, issuance of, and changes in the FAR” (Manuel,
Halchin, et al. 2012, 12). As previously discussed, to accomplish these
responsibilities the FAR Council creates FAR Teams, comprised of military, civilian
agency, and OFPP advisory personnel, who are responsible for maintaining specific
parts of the FAR. Under the direction of the Civilian Agency Acquisition Council
(CAAC) and the Defense Acquisition Regulations Council (DARC), the respective FAR teams draft proposed FAR amendments to be submitted for approval. The CAAC and DARC coordinate their activities and peer review changes proposed by the other council. In the event disagreements occur between the two councils, the Council Chairpersons will resolve the issue; if unsuccessful, the chairpersons will escalate the issue to "successively higher levels in GSA, National Aeronautics and Space Administration (NASA), and Department of Defense (DOD) until agreement is reached. If the Administrator of General Services, the Administrator of NASA, and the Secretary of Defense cannot resolve a Council disagreement, the disagreement will be referred to the Office of Federal Procurement Policy" (U.S. General Services Administration 2015).

The CAAC and DARC submit their approved amendments to OFPP and the Office of Management and Budget’s (OMB) Office of Information and Regulatory Affairs (OIRA) for a compliance review to ensure the proposed or final rules are consistent with existing legislation. Jointly, the Administrator of OFPP and the Director of OMB have the authority to reject proposed changes that conflict with the FAR. This internal control function is key to preserving the integrity of the FAR system. Upon approval by OFPP and OIRA, signatories within DOD, GSA, and NASA execute the amendment prior to its publication in the Federal Register.
The FAR Council and the OFPP Administrator promulgate proposed and final rules to modify the FAR by implementing the “notice-and-comment” procedure as stipulated in the Administrator Procedure Act (APA). The process allows specific time frames for the issuance of the notice of proposed changes and the receipt of comments from interested parties. Specifically, the process comprises the following four steps:

1. Publish proposed rule in Federal Register.
2. Allow period for comments from interested parties.
3. Publish final rule with concise general statement of the "basis and purpose" of the rule.
4. Wait 30 days after final rule publication before rule takes effect. (Manuel, Halchin, et al. 2012, 11)

Each step is an integral part of the process; however, agencies have the flexibility to deviate from some of the requirements if they are capable of justifying such action. For example, the notice and comment feature, by its very nature, extends or delays the rulemaking process. Provided an agency can determine and justify that it is contrary to the public’s interest to utilize this feature, it may first publish a rule in the Federal Register and subsequently request post-promulgation comments (5 U.S.C. § 553 (b) (B)).

In terms of a timetable for amending the FAR, the process can take anywhere from several months to years before the promulgation of a final rule. There are many factors that could impact the process, including the receipt of excessive comments from interested parties or Congressional intervention that
deliberately impedes the process. It is not unusual for a FAR amendment to take longer than the time period stipulated by statute for the amendment to be effective. For example, according to the Small Business Jobs Act, PL 111-240 (Sept. 27, 2010) the FAR was to be amended to incorporate its provisions within one year after enactment of the law; however, the Small Business Administration (SBA) did not promulgate the final rule until October 2, 2013 (U.S. DOD, GSA, and NASA 2015, 81887).

**Requirement for Competition in Contracting**

As previously discussed, the overall vision of the FAR system is to provide the government customer with timely delivery of quality goods and services, while “maintaining the public trust and fulfilling public policy objectives . . . [and to] minimize administrative operating costs [and] conduct business with integrity, fairness, and openness” (Manuel, Halchin, et al. 2012, 9). A major, nearly insurmountable obstacle to achieving this vision is the ongoing practice of circumventing the competition requirements of the FAR and subsequent legislation, which has historically resulted in rampant fraudulent activity. Favoritism, rather than competition, adversely affects the government’s ability to achieve best value, minimize cost, and promote fairness and transparency.

U.S. lawmakers have long recognized competition as being the pillar or requisite component of an efficient and effective federal procurement system. In fact, the first law requiring competition in federal procurement dates back to 1809
(Manuel 2011). The competition requirements of FAR Part 6, which align with the tenets of the Competition in Contracting Act (CICA), call for full and open competition to ensure the attainment of superior quality goods and services at a reasonable cost to the government.

Competition offers key benefits that are germane to the realization of the FAR’s vision: 1) it requires the vendor to offer its best commodity and price in order to win, which demonstrates fairness and best value; 2) it reduces fraud by constantly changing vendors, thus avoiding the formation of unethical government-contractor relations; and 3) it offers taxpayers transparency into the vendor selection process. According to 41 USC § 403(b), full and open competition occurs when “all responsible resources are permitted to submit sealed bids or competitive proposals.” A resource must be capable of demonstrating financial, professional, technical, and ethical responsibility in the performance of its business operations. Specifically, a responsible resource meets the following criteria:

1. Has adequate financial resources to perform the contract or the ability to acquire such resources;
2. Is able to comply with the required or proposed delivery or performance schedule;
3. Has a satisfactory performance record;
4. Has a satisfactory record of integrity and business ethics;
5. Has the necessary organization, experience, technical skills, and accounting and operational controls, or the ability to obtain them;
6. Has the necessary production, construction, and technical equipment and facilities or ability to obtain them;
7. Is otherwise qualified and eligible to receive an award under applicable laws and regulations. (Manuel 2011, 7)

Despite the passing of legislation demanding the use of full and open competition, fraud, waste, and abuse persisted. Between 1984 and 1985, "over half of the top 100 defense contractors were enmeshed in approximately 200 fraud investigations and nearly 100 individuals and companies had been indicted in the product substitution area alone" (Nagel 2012, 161). These improprieties continued well into the latter part of the decade, climaxing in the infamous pentagon scandal and the Department of Justice's notorious investigation — Operation Ill Wind. Over a two-year period, the Department of Justice conducted a covert operation to uncover improper procurement activities that included the sale of contracts to preferred vendors, dissemination of procurement-sensitive data to select vendors, and the release of source-selection information during the bidding process.

The investigation involved hundreds of FBI agents who raided over 40 targeted sites across the country, seizing voluminous incriminating evidence. "The Justice Department grabbed well over two million documents; intercepted more than seventy-six thousand phone calls on more than three dozen court-approved wiretaps from California to New York. Truckloads of seized evidence jammed leased warehouses" (Nagel 2012, 162).

The operation revealed misconduct on the part of high-ranking officials, such as Victor D. Cohen, Deputy Assistant Air Force Secretary, who pleaded guilty
to accepting bribes and conspiring to defraud the government. According to the Los Angeles Times, "In return for favors, payments and the promise of additional funds, [Cohen] ‘improperly influenced procurement decisions’ and provided 'sensitive information' to selected companies to help them obtain Pentagon contracts" (R. Jackson 1991). The case was of such magnitude that U.S. Attorney Henry Hudson employed a staff of nearly a thousand investigators and prosecutors to facilitate the investigation.

**Criminalization of the Procurement Process**

In response to findings under Operation Ill Wind, Congress passed the Procurement Integrity Act of 1988 to provide stringent remedies against persons engaging in procurement misconduct. According to Senator John Glen, "the purpose of the Act was to break the back of the ‘old boy’ network where consultants garnered information and favors to give individual contractors an unfair advantage over their more scrupulous competitors" (Nagel 2012, 162). It is noteworthy that the act criminalized improper activities at the vendor, corporate entity and government level. Vendors soliciting source selection data during an active procurement could face up to five years in prison and fines up to $100,000 for individuals, or $1 million for corporate entities. Likewise, government personnel providing such information could face up to five years in prison (Nagel 2012, 163).
Passing of the Procurement Integrity Act was just the tip of the iceberg. Congress was now more resolute than ever in its commitment to clean up a foul system. As such, what followed during the ensuing years was massive legislation focused on criminalizing improper activities, requiring vendor accountability, and snuffing out fraud against the government.

**FAR Amendments: Contractor Code of Business Ethics and Conduct**

February 16, 2007, the CAAC and DARC promulgated a proposed rule to address requirements for a contractor code of business ethics and conduct. The two primary changes to the FAR are published under Clause 52.203-13 and involve (1) the requirement for government contractors to have a code of business ethics and conduct and to promote compliance with the code within the organization; and (2) the development of an Ethics Awareness program and internal control system. The SBA Chief Counsel for Advocacy submitted comments regarding the rule that stipulated the necessity for the Councils to conduct a Regulatory Flexibility Analysis to ascertain the extent to which creating an ethics program would impact small businesses, and ultimately their ability to comply. The Chief Counsel indicated that the minimal start-up cost for such program would be $10,000, which did not include ongoing administration and training costs. Therefore, the Chief Counsel concluded the imposition of this requirement would pose a disproportionate financial burden on small businesses (SBA Office of
Advocacy 2007). As such, the FAR Councils agreed to exempt small businesses from this provision.

FAR Clauses 52.203-13 provides the mandatory requirements for contracts meeting the clause prescriptions as outline at subpart 3.1004. Specifically, 52.203-13 applies to all contracts in excess of $5,500,000\(^2\) that have a performance period of greater than 120 days. In response to the numerous comments from both industry and government, the FAR Councils promulgated an additional proposed rule under Case 2007-006 to “amplify the requirements for a contractor code of business ethics and conduct, an internal control system, and disclosure to the Government of certain violations of criminal law, violations of the civil False Claims Act, or significant overpayments” (U.S. DOD, GSA, and NASA 2008, 67064). The new final rule implemented the Close the Contractor Fraud Loophole Act, PL 110-252, Title VI, Chapter 1.

This final rule as recorded in the Federal Register again amends the Federal Acquisition Regulation to require government contractors as follows:

- Establish and maintain specific internal controls to detect and prevent improper conduct in connection with the award or performance of any Government contract or subcontract [for businesses other than small];

and

\(^2\) The original version of FAR Clause 52.203-13 established a threshold of $5 million. In October 2015, the Councils adjusted the threshold to $5.5 million to account for changes in the economic environment.
• Timely disclose to the agency Office of the Inspector General, with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of a Government contract performed by the contractor or a subcontract awarded thereunder, the contractor has credible evidence of a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or a violation of the civil False Claims Act. (31 U.S.C. 3729–3733)

The rule also amended FAR Sub-Part 9.4, which details the government’s policy on Debarment, Suspension, and Ineligibility. Effective December 2008, the Councils expanded the scope of activities subject to debarment and suspension to include knowing failure by a principal, until three years after final payment on any government contract awarded to the contractor, to timely disclose to the government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence as follows:

A. Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;
B. Violation of the civil False Claims Act; or
C. Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in FAR 32.001. (U.S. DOD, GSA, and NASA 2008)

As a result of the government’s renewed focus on contractor accountability, suspension and debarment activity has been on the rise. Suspension and debarment actions were up 7.6 percent from 4,812 in fiscal year 2013, to 5,179 in fiscal year 2014 (U.S. Interagency Suspension and Debarment Committee 2015).
The trend has continued upward since 2009 when the Interagency Suspension and Debarment Committee (ISDC) first began to track the statistics. The ISDC indicated that the increase in numbers does not represent a more successful program, but admitted there is pressure for agencies to establish suspension and debarment programs and to utilize the process to protect the interests of the government (U.S. Interagency Suspension and Debarment Committee 2015).

The FAR is a massive regulation that provides the over-arching governance for all activities related to the Government’s acquisition of goods and services. The graphic below depicts a high-level representation of the FAR framework.

![Figure 2.1. The FAR framework. Illustration based on data from the U.S. Code of Federal Regulations Title 48, 1 Federal Acquisition Regulation 2016.](image)

The figure depicts various aspects of the FAR and how they pertain to government employees vs. contractors. The left side references the guidance and prescriptions that are government-focused, including policies and procedures as well as standards of conduct for employees involved in the acquisition process. The right
side shows the primary contractor-focused requirements, which include contractor qualifications and the new ethics provisions. Fair and open competition forms the basis of the system.

Summary

The complexity and extent of the Government’s acquisition activity necessitated the development of a centralized procurement system to standardize policies and procedures across affected Executive Agencies. The system’s primary objective was to increase efficiency in the purchase and delivery of quality goods and services by promoting fair competition among ethical contractors. Amendments to the FAR established more rigorous ethics requirements in an effort to ensure its industry partners conducted business with integrity and were accountable for their actions. To demonstrate the sincerity of this effort, the government has expanded the scope of actions that trigger suspension and debarment activities. As a result, suspension and debarment activity is on the rise, which should be problematic to small businesses because they are more likely to face suspension and debarment than their large business counterparts for several reasons:

- Their services or products are more expendable (generic).
- They often lack resources for a good legal defense.
- They typically lack a formal ethics program with internal controls due to cost.
• They are often unaware of changing legislation and requirements for compliance; therefore, they may be oblivious to their own non-compliance.
• They may not understand how to comply. (Author’s summary)

In an environment where the government is demanding increased contractor “accountability and integrity”, the small-business government contractor is at risk of non-compliance. The challenge is for small businesses to successfully align corporate objectives with the ethics objectives of the government and apply the necessary measures to realize those objectives. This requires the implementation of a beyond-compliance effort. Failure to do so could ultimately have devastating consequences for the contractor.

Therefore, small-business government contractors must strive for beyond compliance to protect themselves from possible suspension or debarment and to be in sync with the government’s program. A first step towards this end is to be selective in choosing the code of conduct that will drive the organization’s ethics effort. The FAR does not stipulate what areas the code of conduct must address; however, adopting and promoting compliance with a code of business conduct that addresses market transactions – transactions between the government and contractor, would align well with the framework of the FAR, whose main goal is to promote fair competition in the acquisition process. The following chapter will provide a detailed discussion of this Market Failures Approach to business ethics and demonstrate how the same principles that underpin the market economy can
produce a robust code of ethics that will facilitate compliance and avert activity that impedes competition and creates market failures.
CHAPTER 3

THE MARKET FAILURES APPROACH TO BUSINESS ETHICS

The changes to the Federal Acquisition Regulation (FAR) incorporate rigorous ethics requirements into the procurement process for firms that conduct business with the Federal Government. The purpose of such amendments is to ensure that the government’s industry partners are conducting business transactions in such a manner as to promote and comply with fair competition. Ensuring that the acquisition process is fair and competitive has been the primary objective of much legislation that has been promulgated over the past four decades. The new provisions mandating an ethical standard represents a sea change in the government’s approach to ensuring contractor accountability.

For firms other than small business, the ethics provisions entail the development and inculcation of an ethics program (to include education and training) into the institution; the implementation of an internal control system to timely detect criminal activity, accounting improprieties, fraud, abuse, and the like; and the development and adoption of a business code of conduct. However, the government exempted small business from all the provisions except the requirement to timely disclose criminal activity and to develop and comply with a contractor code of conduct.
In this chapter, the author will demonstrate that the government’s omission of specific instructions regarding the structure of the code of conduct for small businesses will likely produce the development of a variety of codes of conduct that may not necessarily align with the government’s objectives. In such cases, attaining compliance with requirements that fail to advance the agenda for fair competition and contractor accountability would be meaningless. The author will further demonstrate that the distinction between internal transactions (administered) and external ones (market) is key in developing the type of business code of conduct that fits squarely within the framework of the FAR and thus aligns with the government’s goal to promote fair competition. To accomplish this, the author will present Joseph Heath’s Market Failures Approach to business ethics, which is based on transaction cost economics.

Section one, Business Ethics Overview, provides an operational definition of business ethics as used in this text and addresses the significance of a moral code in business. It also analyzes popular theories and approaches to integrating ethics into business practices. Section two, Market Failures Approach, discusses administered vs. market transactions as well as profit maximization and the justification of profit. Finally, it details the market failures approach to business ethics and demonstrates why this approach is preeminent in achieving the
government’s objectives that are both implicit and explicit in the FAR ethics requirements.

**Business Ethics Overview**

Ethical theory is the branch of inquiry that focuses on understanding morality; therefore, business ethics, meanwhile, concerns the rightness, wrongness, and fairness of behavior within a business setting, often focusing on managerial behavior. The principles approach to ethics, which is based on specific rules and principles, provides the manager with the requisite framework for making moral decisions. That is, the principles function as rules or guidelines to assist the manager in making the moral choice when confronted with an ethical decision. There are many varieties of ethical theories, including virtue ethics, consequentialism, and deontology. Virtue ethics is agent-centered and focuses on the basic character and motivation of an individual agent (e.g., Aristotelian ethics); consequentialist theories are state-of-affairs oriented and focus on outcomes or consequences (e.g., utilitarianism); while deontological theories are action-based and focus on duties or obligations (e.g., Kantianism).

Many ethicists assert that conscientious people tend to be ground guided when making moral decisions; that is, their decision is based on some type of theory, whether they realize it or not. Further, ethical decisions are precedential, meaning given two similar situations, the conscientious person will act the same or have the same “ought” in both cases. Therefore, ethical theories are essential to
business ethics as they “help one to find and articulate grounds to justify decisions by appeal to them, and to generalize from good decisions to rules that can guide future conduct and facilitate good decisions in the future” (Audi 2010, 61).

Integrating theories of business ethics into business practices has been and remains an ongoing challenge. While there are varying opinions and approaches to applying moral principles to business ethics, “it has generally been understood in the field that normative ethical theory provides the tools necessary for analysis and informed discussion of ethical issues in business. This gives normative ethics a primacy of place in business ethics” (Green and Donovan 2010, 27).

Normative business ethics is concerned with supplying a principle-based moral framework that establishes standards to direct or evaluate business practice. That is to say, it endeavours to devise a system of moral principles to guide moral actions—decision making and behavior. “Normative business ethics, therefore, seeks to propose some principle or principles for distinguishing what is ethical from what is unethical in the business context. It deals more with ‘what ought to be’ or ‘what ought not to be’ in terms of business practices” (Carroll and Buchholtz 2006, 175). In a business setting, an executive would appeal to normative principles when facing a moral dilemma to justify or determine the permissibility of a practice.
There are essentially two distinct approaches to incorporating ethics in business. First, as discussed above, there is the action-based approach in which one develops principles and guidelines to constrain management’s actions. When making a moral decision, the manager appeals to the appropriate rules to determine what one “ought” or “ought not” to do. Second, there is the agent-based approach, which focuses on the basic character and motivation of the individual agent. While the latter approach has gained some traction in recent years, the former remains predominant. Therefore, this paper only addresses action-based approaches to business ethics.

*Rationale for categorizing business ethics as professional ethics*

Business ethicists have long contended that business is a form of professional ethics, similar to medical and legal ethics. In fact, many modern claims are predicated on the acceptance of business ethics as a professional ethics. In the essay “Business Ethics Without Stakeholders,” Joseph Heath contends one can easily justify this classification by considering the obvious parallels that exist in the obligations and requirements to make moral decisions during the course of performing the day-to-day duties of the profession. That is, the profession, in and of itself, imposes obligations upon the professional in fulfilling his or her role, be it doctor, lawyer, or manager. “In the same way that medical and legal ethics stem from questions that arise within the profession, business ethics deals with
questions that arise out of the professional role of managers” (Heath 2006, 534). It is important to note that the obligation is an integral part of the professional role.

At this point it is prudent to distinguish between the role of an employee within a business and that of a business manager in order to validate the professional nature of the managerial role. The employee differs from the manager in that he or she typically has no fiduciary or other responsibilities outside the contract and his or her performance is subject to monitoring. The manager, on the other hand, has fiduciary responsibilities involving trust because of unspecified contractual obligations and information asymmetries between the shareholder and manager, as well as manager and customer. “In such cases, it is impossible to eliminate moral hazard, and so [for example] the purchaser of labor services must rely in large measure upon the voluntary cooperation of the seller in order to secure adequate work effort. Thus a certain amount of trust, or moral constraint, is required in these relationships” (Heath 2006, 535).

Some argue that the hallmark of a true profession is the existence of certifications and associations that establish and share a common body of knowledge. This is certainly true for the medical and law professions. The problem is that such organizations create information asymmetries, which can lead to market failure and adversely impact market transactions for the services the group members offer. In order to offset the information asymmetry, the professional
must instill trust into the relationship with the customer. Oliver Williamson refers to this situation as “information impactedness,” where the purchaser of goods or services lacks the requisite knowledge to make a sound decision regarding the service, and the purchaser has no means to evaluate the quality or effectiveness of the service the supplier recommends. The purchaser is reliant upon the trustworthiness of the supplier; therefore, “specialists must work hard to cultivate trust among potential purchasers of their services. A certification system, along with a professional association that imposes a stringent code of conduct, is one way of achieving this objective” (Heath 2006, 537).

One can deduce there is a positive correlation between the level of information asymmetry and the requirement for trust. That is, the higher the information asymmetry, the higher the trust requirement that one must foster with the purchaser. For example, in both medicine and law the information asymmetries are sufficiently high so as to warrant the formation of professional organizations—a Medical Board and the BAR Association—that impose very stringent codes of conduct and ethics that exceed mere compliance with labor and contract law. The objective of this beyond-compliance stance is to instill trust among potential users/purchasers of these services. While professional managers have not organized themselves into specific associations, the managerial role is
professional nonetheless, in that it requires the manager to be both trusted and trustworthy in conducting his or her professional responsibilities.

*The significance of a business code of conduct*

The preceding section outlined the justification for classifying business ethics as a kind of professional ethics at parity with both legal and medical professions because of the fiduciary responsibility and obligations of trust that are inherent in the role of the business manager. However, it also pointed out that unlike the legal and medical professions that are organized around associations having strict ethics standards, in business there is no such association. Hence, the development of and compliance with a business code of conduct is vital in order to foster the requisite trust between customer and supplier.

The code of conduct is the foundation underpinning an organizational ethics program. It is noteworthy that in amending the FAR to incorporate stricter ethics requirements for government contractors, the government recognized the tremendous financial burden to small businesses that the provisions would create; therefore, it waived essentially all requirements except the contractor code of conduct.¹ But, how important is a code of conduct? Can it really be an effective tool in promoting ethical business practices?

¹ While the requirement for timely disclosure of criminal activity was not waived, it is important to note that the essence of this requirement already existed in the US Federal Sentencing
Dan Ariely, a professor of psychology and behavioral economics, has done considerable work focused on the human capacity for both honesty and dishonesty that has added another dimension to the way one views ethics at the professional and personal level. He uses empirical data to validate his broad claim that, “people don’t need to be corrupt in order to act in problematic and sometimes damaging ways. Perfectly well-meaning people can get tripped up by the quirks of the human mind, make egregious mistakes, and still consider themselves to be good and moral” (Ariely 2012, 70). If true, these findings have considerable relevance to ethics in general, and business ethics in particular. It is commonly thought that rules and business codes of conduct are not developed for the vast majority of persons in the company, but for those few “bad apples” that may tend to veer towards the outer limits of morality. Ariely, however, is making a categorical claim that everyone has the propensity to engage in varying levels of dishonest behavior — both those who are corrupt and those who perceive themselves as moral. He ultimately concludes, however, that moral reminders, including emphasizing a code of conduct, can decrease dishonesty (Ariely 2012, 43).

According to Ariely’s theory, there are two opposing motivations that drive our behavior: (1) Ego motivation, which is our desire to view ourselves as honest and honorable; we want to feel good about ourselves; and (2) Financial motivation,

Guidelines. The amendment essentially implemented or aligned the FAR with the sentencing guidelines with regards to contractor disclosure requirements.
which is our desire to benefit from cheating and get as much financial gain as possible (Ariely 2012, 27). We reconcile the two by using “cognitive flexibility,” that is we manipulate the flexible boundaries of our ethics. A classic example is cheating on taxes by rationalizing a reclassification of personal expenses as business expenses — a personal meal suddenly becomes a business expense by merely mentioning any work-related issue while eating. This reduces our tax liability, while the rationalization makes our action seem permissible in our view, so all is well.

Cheating and dishonesty, regardless of the degree, are communicable and potentially dangerous, claims Ariely. When left unchecked, they are capable of eroding the ethical culture of the environment. In his book, *The Honest Truth About Dishonesty*, Ariely writes:

> From this perspective, it's important to realize that the effects of individual transgressions can go beyond a singular dishonest act. Passed from person to person, dishonesty has a slow, creeping, socially erosive effect. As the “virus” mutates and spreads from one person to another, a new, less ethical code of conduct develops. And although it is subtle and gradual, the final outcome can be disastrous. This is the real cost of even minor instances of cheating and the reason we need to be more vigilant in our efforts to curb even small infractions. (Ariely 2012, 214)

Ariely contends there are many forces, both external and internal, that serve as catalysts for our dishonesty. For example, an environment with rampant dishonesty may very well influence individuals toward dishonest behavior; or, an individual’s “cognitive flexibility” may allow one to rationalize an act that one
would normally consider dishonest. The graphic below depicts a balance with the forces of dishonesty on the one side and the methods of remediation on the other.

Figure 3.1. Summary of the Forces that Shape Dishonesty. Illustration from Dan Ariely 2012, 245.

The illustration, though representative, implies there are myriad factors that perpetuate dishonest behavior in an organization. Remediating dishonesty, however, is basically limited to supervision and various techniques of moral suasion, including appeals to a code of conduct, code of honor, pledges,
commitments, and the like. Ariely’s research supports the claim that a credible and robust code of conduct can be an effective tool in mitigating dishonest behavior, thus promoting or helping to maintain an ethical culture within the business context.

**Popular Approaches to Business Ethics**

*Shareholder Theory*

The Shareholder model places significant emphasis on the for-profit organization’s mission to generate wealth for its shareholders (owners). As such, the managers, who are agents for the owners, have the distinct obligation to conduct business in a fiscally responsible manner so as to achieve profit maximization in fulfillment of their obligation. This classic view of the firm’s purpose, which has been prevalent in academic circles for years, “is a moral position in that owners have moral rights and managers have moral obligations to them” (Bowie 2010, 703).

Shareholder theory focuses primarily on wealth creation for shareholders with little emphasis on social responsibilities or other relationships that are integral to ongoing business operations. The theory is limited to the view that managers are obligated primarily or exclusively to the owners of the firm. As such, they are bound by their agency relationship to do with the owner’s property what the owner desires. Further, barring explicit instructions from the owners, they may
assume that profit-maximization is the owner's goal. In their role, “managers have substantial liberty as to specific actions, [but] they are not free to use company resources in ways that they could reasonably foresee would not advance the shareholders’ interests” (Levy and Mitschow 2009, 4). In this regard, it differs greatly from stakeholder theory, which has a broader perspective and focuses not only on wealth creation, but also on relationships with constituent groups including, depending on how wide or narrow the specific stakeholder theory is, employees, customers, suppliers, the community and society as a whole.

Shareholder theory, which is widely regarded as consistent with the economic concepts that Adam Smith espoused in *The Wealth of Nations* — the primary function of a business is profit maximization and wealth creation—embraces three of his key tenets:

1. The importance of “free” markets;
2. The “invisible hand of self-regulation;”
3. The importance of “enlightened self-interest.” (Pfarrer 2010, 86)

Proponents of this theory advocate self-regulation as opposed to government intervention because it is through the “invisible hand” that resources are efficiently allocated to the benefit of society as a whole. Firms acting out of self-interest will compete with one another for profit, driving the prices for goods and services to a level that clears the market.
Over the past four decades, Milton Friedman, an exemplar of modern-day shareholder theory, remained resolute in his view that the only social responsibility of businesses was to involve themselves solely in business-related activities; social programs and public policy should remain the responsibility of the government. That is, the executive manager’s expertise is in corporate management, not public administration; therefore, requiring the executive to work outside his domain is a misallocation of resources that will ultimately affect society negatively. He further contends that “Corporate philanthropy and other activities not directly related to generating shareholder wealth are both a waste of shareholders’ money and, potentially, immoral because they amount to stealing from owners” (Pfarrer 2010, 87).

Friedman clearly advocated the application of ethical business practices as firms endeavor to maximize profits and shareholder wealth. He argued that “this [profit maximization] must be done within the moral, ethical, and legal boundaries of society. He asked only that government and the citizenry assume their rightful roles in creating those boundaries” (Pfarrer 2010, 87).

Currently, there are two schools of thought based on shareholder theory: Transaction Cost Economics (TCE) and Agency Theory. Both theories assume individual are inherently opportunistic. While employees, managers and shareholders all have an interest in the success of the firm, each group has its own
individual interests as well, which can conflict with the common interest (Heath and Norman 2004, 252). All are prone to placing self-interest above the interest of the firm; therefore, each theory seeks to corral self-interest and channel it in such a way that it supports corporate objectives. The approach to address this conflict varies between the two theories:

TCE focuses on the importance of corporate hierarchies and monitoring employee behavior to minimize self-interested behavior; [while] agency theory focuses primarily on the principal vs. agent (shareowner vs. manager) relationship in publically traded firms, and how to best align the competing interests of the two parties to maximize firm value. (Pfarrer 2010, 87)

The two theories advocate monitoring and incentivizing managers and executives. Typically, the incentive system ties individual incentives to fiscal performance of the firm so the manager and executive receive incentives commensurate with their contribution to corporate objectives.

*Transaction Cost Economics*

Transaction Cost Economics (TCE), which focuses on the individual cost of an economic exchange, is an interdisciplinary field incorporating economics, business history, organization theory, and contract law. It is a theoretical framework for predicting when the price mechanism should direct the allocation of resources, and when the firm should direct resource allocation. The individual transaction is “the unit of analysis in the transaction cost economics setup . . . [and] the critical dimensions of transactions are complexity, the condition of asset
specificity, and the disturbances to which a transaction is subject” (Williamson 2010, 680).

The firm, a key component of the economic system, emerged as a means to more efficiently conduct some transactions by eliminating certain marketing costs such as the cost to negotiate separate contracts for each exchange transaction. Ronald Coase, an exemplar of transaction cost economics and the first to introduce this concept within the context of the firm and market organization in his classic essay, The Nature of the Firm, writes, “The operation of a market costs something and by forming an organization and allowing some authority (an “entrepreneur”) to direct resources, certain marketing costs are saved” (Coase 1937, 392).

Coase did not actually coin the name “transaction cost economics;” however, his writings clearly espoused the concepts that revealed a significant gap between the assumptions that underlay the two alternative approaches to coordinating production — the price mechanism (for exchange transactions) and the firm. He found as follows:

Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, however, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production. (Coase 1937, 388)

The issue that he set out to address in the paper was how to derive the decision to use one mode over the other. Transaction cost was the missing concept
Transaction Cost Economics, which is the theory that underpins Joseph Heath’s Market Failures Approach to business ethics, is discussed in detail later in this chapter.

Agency Theory

Agency Theory addresses how to organize relationships in which one person (the principal) engages another (the agent) to work on the principal’s behalf to accomplish specific goals that are in the principal’s best interest, but not necessarily the agent’s. A key assumption of the theory is that “both principal and agent are motivated by self-interest . . . [which] dooms agency theory to inevitable inherent conflicts. Thus, if both parties are motivated by self-interest, agents are likely to pursue self-interested objectives that deviate and even conflict with the goals of the principal” (Seven Pillars Institute n.d.).

As a means to align the agent’s objectives with those of the principal, most principal-agent relationships incorporate both external and internal controls. That is, they use incentives (external) and moral suasion (internal) as effective tools to this end. Employees with compensation tied to incentives tend to be sufficiently motivated to comply and focus on the principal’s interest. However, “in fiduciary relations . . . external incentives tend to be extremely weak, and so principals depend very heavily upon moral constraint on the part of the agent to secure compliance” (Heath and Norman 2004, 252). In other words, moral suasion is the
technique that proves to be most effective when dealing with corporate managers and their obligation to the owner.²

Essentially, agency theory is concerned with resolving two problems that can arise in agency relationships. The first occurs in situations where the interests of the principal and agent conflict, and the principal is unable to fully monitor the agent’s activity to determine what the agent is doing. It is difficult and costly for shareholders to effectively monitor management, particularly if ownership is widely dispersed. This is due primarily to “the magnitude of the information asymmetries that exist between the two groups, and the sheer cost associated with acquiring the information needed to assess managerial performance” (Heath and Norman 2004, 253). Engaging in oversight activities requires substantial resources; therefore, where ownership is highly diffuse, the individual shareholder has no incentive to expend resources to monitor and discipline management, as the cost could conceivably exceed the individual investment.

In instances where interests conflict and activities are not fully observable, there is always the potential for abuse and collective action problems. While a “successful firm is a ‘public good’ for its members . . . individually selfinterested

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² It is noteworthy that this assertion conforms to the findings of Dan Ariely’s research and ultimately his theory as described earlier in this chapter. Monetary gain had a neutral effect on dishonesty, while moral suasion (moral reminders, pledges, commitment) and supervision tend to decrease dishonesty.
action will fail to secure it” (Heath and Norman 2004, 252). Managers may take advantage of their position and proprietary knowledge to advance their own self-interest at the shareholders’ expense. Additionally, employees and/or managers may engage in “free riding”, where they deliberately underperform but still reap the benefits resulting from the high performance of others. These collective action problems often occur between employee and supervisor, as well as manager and shareholders.

The second agency problem involves risk sharing and may occur in instances where there is significant divergence in the principal and agent’s philosophy towards risks. “The problem here is that the principal and the agent may prefer different actions because of the different risk preferences” (Eisenhardt 1989, 58). For example, an agent with an aggressive perspective may be involved in activity deemed “risky” by the principal, although the agent is indeed working diligently to fulfill his or her obligation to the shareholder. In such case, the shareholder may perceive that the agent is taking unnecessary risks at the shareholder’s expense. Conversely, an aggressive principal may view an agent’s action as unambitious or slothful, while the agent’s intent may be to implement a conservative approach as a means to avoid risk or loss to the principal.
Shareholder Theory as the basis for a normative ethics

A normative ethics based on shareholder theory would center around obligations stemming from (1) the shareholder as owner and primary stakeholder warranting a special duty of care, and (2) profit-maximization as the primary objective of the tasks that managers perform on behalf of the shareholder. Proponents of shareholder theory assert that owners -- shareholders -- rightfully hold a position of primacy because they invest in the firm, providing essential capital, without any guarantee of a return on their investment. The shareholder is able to mitigate risk to a certain extent by performing oversight of corporate management (often through a board) as a means of protecting their interest. Thus, “only by according shareholders a special role in protecting their stake in the firm can we expect managers to run the firm in a way that is in the long-term interests of other groups with a stake in the firm (such as employees, suppliers, customers, bondholders, lenders, etc.)” (Heath and Norman 2004, 261).

As owners, shareholders have the right to dictate how their resources are used, and the manager has the fiduciary responsibility to ensure the owners’ desires for their property are carried out. Further, owners have the right to direct the manager to engage only in activities that maximize their return on investment.

Shareholder theory recognizes the shareholders’ property rights and the associated moral obligations the rights afford them. As such, opponents of this view argue that shareholder theory essentially limits the reach of the firm’s moral
obligations to just the shareholders and leaves obligations towards other constituents (those that affect or are affected by the company's activities) unaddressed. These omitted groups make significant contributions to the ongoing success of the company in their varied capacities, as discussed later in this chapter. The implication that managers are not required to exercise moral constraint when dealing with non-shareholder groups is problematic when considering shareholder theory as the basis of a normative ethics. Managers, who routinely interact with external parties such as clients, suppliers, bankers, etc., require a framework to assist them in understanding the extent of their obligations to each party and to provide guidance when facing a moral dilemma. Shareholder theory is clearly lacking in this area.

Opponents of shareholder theory also express their concern about a normative ethics that focuses on maximizing profits for shareholders. Notwithstanding Friedman's directive to stay within the rules of the game when seeking to increase profit, the theory is vague and does not establish clear limitations on activities beyond legal compliance. How far ought a manager go to further the interests of the shareholder? For example, if a manager is able to externalize costs to increase profits, should he or she take advantage of the market failure? It appears that shareholder theory would tell managers to take advantage of those market failures to promote the firm's interest. But, there are definite cases
where most of us are going to see that as obviously false. Friedman’s statement about engaging in competition without “deception or fraud” implies some degree of morality in business practices, but it is not explicit and is open to wide interpretation. As a result, the moral constraints are ambiguous.

Heath supports some tenets of shareholder theory; however, he exudes little enthusiasm when considering it as the sole basis for a normative ethics. He readily points out the inadequacy of the theory to address the varying types of relationships that are integral to the ongoing operations of a firm. He criticizes business ethicists, who have focused narrowly on the fiduciary relationships that exist between senior management and the shareholders, and have extrapolated these fiduciary obligations across the entire organization. He states:

The problem with this conception, however, is that it generates a system of moral obligations that tracks the agency relationships, and thus directly mirrors the organizational hierarchy of the firm. Individuals have duties toward those who are, in some sense, their superiors: employees toward their supervisors, managers toward executives, executives toward the board of directors, and via the board of directors, the shareholders. (Heath 2007, 21)

Edward Freeman, another opponent, makes a Kantian argument against shareholder theory positing that each stakeholder group “has a right not to be treated as a means to an end” (R. E. Freeman 2001, 39). In other words, managers “ought” not seek to increase profits (end) at the expense of stakeholders (means), as it is not permissible to use persons as a means to an end. A related criticism of
the theory is that it enables managers to participate in sharp practices to promote interests of the firm, where they have no obligation to consider the welfare of others.

The omission of obligations to essential groups is a deficiency in the theory that could ultimately undermine the viability of the company. For example, the relationship between the company and the client is vital and requires proper management. Freeman says it is the “lifeblood of the firm in the form of revenue” (R. E. Freeman 2001, 43). He references a study conducted by Peter and Waltermann (1982) and quotes their finding that “being close to the customer leads to success with other stakeholders and that a distinguishing characteristic of some companies that have performed well is their emphasis on the customer. By paying attention to customers’ needs, management automatically addresses the needs of suppliers and owners” (R. E. Freeman 2001, 43). An adequate normative ethics, then, would ostensibly be required to address relationships and obligations other than manager and shareholder.

Stakeholder Theory

Stakeholder theory asserts that corporations owe a duty of care not only to the shareholders, but also to other groups or individuals who affect or are affected by the activities of the company. In determining the components of those groups,
Freeman and Reed provide both a wide and narrow definition of the stakeholder.

The wide sense includes:

Any identifiable group or individual who can affect the achievement of an organization’s objectives or who is affected by the achievement of an organization’s objectives. (Public interest groups, protest groups, government agencies, trade associations, competitors, unions, as well as employees, customer segments, shareowners, and others are all stakeholders, in this sense.) (Freeman and Reed 1983, 91)

This definition is far-reaching and is even inclusive of competitors because the competition can affect the extent to which a company achieves certain goals. For example, an incumbent contractor could lose a bid on its current work to a competitor, which would adversely impact achieving its fiscal objectives. Freeman and Reed indicate that companies must account for the adversarial groups as well, when developing corporate strategy.

The narrow sense, as implied, is more exclusive in its definition of stakeholders. Specifically, it considers stakeholders as described below:

Any identifiable group or individual on which the organization is dependent for its continued survival. (Employees, customer segments, certain suppliers, key government agencies, shareowners, certain financial institutions, as well as others are all stakeholders in the narrow sense of the term.) (Freeman and Reed 1983, 91)

The definition limits the groups or individuals who can claim a stake in the firm to those that are germane to the ongoing operations of the company. Employees, for example, contribute to operations by providing the requisite skills and labor to conduct the business of the firm. There exists an implied contract between
employee and firm, both parties having specific requirements and expectations of
the other. As such, employees have a vested interest in the company because they
rely on it for their livelihood, security, benefits, job, etc., in exchange for their labor.

Customers, also deemed vital to the successful existence of a firm,
constitute the "lifeblood" of the business because they form the revenue base. The
receipts, which provide capital to fund operations, contribute to profit and impact
fiscal performance. The customer's interest in the company is not limited to the
goods or services that it purchases, but it includes the ensuing business
relationship that guarantees a reliable source of goods to meet future
requirements. Similarly, the firm is dependent on all the stakeholder groups to
ensure its viability, and the stakeholders in return have specific expectations of the
firm. Therefore, the relationship is interdependent. The graphic below illustrates a
narrowly defined stakeholder model.
The very tenets of stakeholder theory require the firm to systematically manage the interests of the various stakeholder groups and prioritize competing interests by salience to the firm. This is necessary because "the theory does not give primacy to one stakeholder over another, though there will surely be times one group will benefit at the expense of others" (R. E. Freeman 2001, 42). It is important for firms to "understand ‘who counts’ under what particular circumstances, as well as how this ‘hierarchy of salience’ can change depending on the relative power of stakeholders, the legitimacy of their claims, and the urgency of their claims on the company" (Pfarrer 2010, 89). Grouping by salience is a necessary process that serves to inform the firm’s decision to favor one group’s interest over another in a particular circumstance. For example, over the past few
decades large U.S. retailers have come under fire for patronizing “sweatshop” factories that violate human rights and disregard established codes of conduct. Some firms, such as Walmart, have responded to the legitimate claims by investing capital to increase the frequency of audits and monitoring the activities of its Asian suppliers; they also terminated relationships with factories guilty of committing more egregious infractions. (Roberts and Engardio 2006). In this instance, the allegations against the firm were of high salience and thus deemed a priority for resolution despite any associated costs.

Various theories have emerged that are expansions of the Stakeholder model. Recently, there is the development of the “symmetric” communications theory that focuses on the relationship between companies and their environment. The theory, which increases the scope of stakeholders to include the media and activists, looks at the interdependence of all stakeholder groups and seeks to find a “win-win” solution when there are competing interests between the firm and the other groups. “The perspective looks for a process in which firms and their stakeholders both seek their own advantage while, at the same time, respecting the needs of others” (Pfarrer 2010, 90).

An emerging school of thought that focuses on the altruistic nature of human behavior has developed theories related to the stakeholder model that have gained substantial traction in academia and in the business world in recent
years. (In fact, Google has incorporated such approach to their business decision-making process.) Two particular theories of this type are “stewardship” and "social capital theory.” Unlike agency theory that assumes human beings are opportunistic and likely to place their own interests above those of the organization, stewardship theory claims that human beings may indeed place the interest of others above their own.

The social capital theory “assumes that organizational actors also have a proclivity for goodness and self-enlightened behavior that can add value to the firm. ... [The] theory assumes the potential for cooperation among employees and shareholders for the overall betterment of both individual and the firm” (Pfarrer 2010, 90). That is, the theory assumes employees will realize personal satisfaction in addition to monetary gains because of their willingness to work to the overall benefit of the organization.

Proponents of social capital theory assert that approaching organizational dynamics with the traditional economist’s perspective of the opportunistic and distrustful manager results in a self-fulfilling prophecy. The measures that the firm takes to curtail potential opportunistic behavior creates an environment in which the employee feels distrusted and is more likely to engage in the very behavior that the firm seeks to impede (Pfarrer 2010, 90). Social capital theory proponents
attempt to transform what they regard as a "vicious circle" to a "virtuous circle" where trust and confidence placed in employees empower them to be trustworthy.

It is interesting that the basis of this approach is in stark contrast to the findings of Ariely's research regarding human behavior discussed earlier in this chapter. He asserts that rational and creative beings use their cognitive skills to find ways to circumvent rules and reinterpret information to satisfy both our ego and financial motivations. If indeed we, as human beings, have the propensity to engage in varying levels of dishonesty, then an approach to ethics that categorically considers only the good in humans is problematic. As Ariely states, “putting our creative minds to work can help us come up with a narrative that lets us have our cake and eat it too and create stories in which we're always the hero, never the villain” (Ariely 2012, 187).

Corporate Social Responsibility (CSR), which is based on stakeholder theory, focuses on how a firm’s actions affect other institutions and constituencies. Archie Carroll, founder and advocate of CSR theory, presents a four-part definition: “The social responsibility of business encompasses the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time” (Carroll and Buchholtz 2006, 35). The graphic below denotes the four components of CSR. It is noteworthy that society requires businesses to
perform economic and legal responsibilities; however, ethical and philanthropic responsibilities are *expected* and *desired*, respectively.

![Diagram of Carroll’s Corporate Social Responsibility Pyramid](image)

Figure 3.3. Carroll’s Corporate Social Responsibility Pyramid. Data from Carroll and Buchholtz 2006.

CSR proponents assert that there exists a correlation between CSR and increased corporate fiscal performance; however, there is no conclusive empirical data to support the claim, as studies have rendered conflicting results. (Pfarrer 2010, 91). For example, S.C. Vance conducted a study of 14 firms in 1975 and found a negative correlation between social performance and economic performance, while Alexander and Buchholz’s study of 40 firms in 1978 found no correlation (Ullmann 1985). Further, in a study of Fortune 500 companies over a
six-year period, findings revealed a significant positive correlation between corporate social performance and profitability (Stanwick and Stanwick 1998); however, results of a meta analysis of 251 studies on the topic over a 35-year period showed only a mildly positive relationship (Margolis, Elfenbein and Walsh 2009). One of the main issues hampering the validation of CSR proponents’ claim that CSR increases fiscal performance is the inability to determine an adequate metric to quantify the effect of CSR on non-capital market stakeholders.

*Stakeholder Theory as the basis for a Normative Ethics*

There are several issues that opponents raise regarding stakeholder theory, as the basis of a normative ethics system. Friedman, who rejects the notion of recognizing obligations to stakeholders other than shareholders, admonishes businessmen and women who believe in a free-market system, yet claim that social responsibilities are an integral part of a firm’s strategic business goals. He posits that such claim is not substantiated and considers this line of thinking as advocating socialism, not free economy (Friedman 1970).

In the article “The Social Responsibility of Business is to Increase Its Profits,” Friedman articulates the primary objective of businesses is profit maximization. A corporate executive, as an employee of the business owner “has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much
money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom” (Friedman 1970). The relationship between employer and executive is principal – agent, where the executive is working as an agent on behalf of the principal (proprietors).

Friedman recognizes that the executive, in his or her role as a person rather than as a manager, has responsibilities that could be classified as “social”, e.g., community work, family, and charity. For such personal endeavors, the executive performs as a principal, not agent, voluntarily selecting responsibilities that he or she will recognize and support using his or her own private resources and personal time. This behavior is morally appropriate, as it does not affect the strategic goals or objectives of the corporation, and does not make use of someone else’s property to accomplish the ends sought.

There is a clear demarcation between personal (principal) and managerial (agent) duties; and these two roles must remain separate. Friedman makes the argument that a corporate executive cannot in his or her agent capacity engage in social responsibility activities that have associated costs. To do so would be to use resources that he or she does not own to support activities that he or she independently selects. Such action is often in direct conflict with the primary goal of the executive, which is to serve the interest of the principal, that is, in most cases, to maximize profits. “This is the basic reason why the doctrine of ‘social
responsibility’ involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses” (Friedman 1970). Of course, should the proprietors decide to engage in social activities that reduce the bottom line, it is fine because a proprietor is the principal and has discretion over the use of his or her own resources. Friedman concludes that “[t]here is one and 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’ (Friedman 1970). His ethics is clear: fair competition without improprieties.

Stakeholder theories all grant that managers do have obligations to shareholders; shareholders’ interests always count. Their disagreement with Friedman and shareholder theorists is in the further claim that non-shareholders may also have interests that ought to count when a manager is making a business decision- even if it comes at the expense of profits or the interests of shareholders- including employees, customers, suppliers, community, etc. Joseph Heath and Wayne Norman point out that this view is problematic because it conflicts with corporate law, which gives shareholders (owners) pre-eminent status. This position comes with substantial legal rights geared towards the protection of their interest. As such, shareholders have the ability to control and influence all
corporate activity through the Board of Directors, whom they elect. “In effect, the shareholders have the right to treat the firm as a vehicle to maximize the return on their investment... it is also fully within its [the board’s] rights to instruct managers to consider the ultimate purpose of the firm to be the maximization of profits and shareholder value” (Heath and Norman 2004, 248).

In the essay “Stakeholder Theory, Governance and Public Management,” Heath and Norman specifically take exception to stakeholder theories that advocate sacrificing shareholders’ interest for the sake of extra-legal and moral obligations to other stakeholders. They assert that such approach cannot work and is self-defeating (Heath and Norman 2004, 261). Companies cannot be sustainable without profitability; inferior fiscal performance that does not generate a return on capital will ultimately impact the firm’s access to capital markets.

Opponents of stakeholder theory also raise a number of other objections to the view as well. So, for example, they assert it is not a justificatory ethical theory. That is to say, the theory does not justify giving the manager the responsibility to decide the priority of stakeholders’ interest when there is conflict. The theory also fails to provide guidance on how to balance competing interests. The theory lacks “a clear compelling normative methodology that would allow corporations, managers, or outside observers to justify which beyond-compliance obligations must be met and how business actors are to trade-off in a reasonable way the
claims of competing stakeholders” (Norman 2011, 47). The theory lacks principled guidance to help managers of firms decide when they must exercise constraint when faced with profitable and legal business opportunities that may be unethical. The most crucial deficiency of the theory as it relates to ethics is that it provides “No inherent ways of drawing careful distinctions between, for example, (i) activities or omissions that are unfortunate but not ethically forbidden, (ii) activities or omissions that are either obligatory or forbidden, and (iii) activities that are permissible and beneficial, but not obligatory” (Norman 2011, 52).

**Market Failures Approach**

For the above reasons, stakeholder theory ought to be abandoned as the basis of normative business ethics. Shareholder theory, as advocated by Friedman, is also problematic, as has been pointed out. The market failures approach is an alternative that appears to overcome the worries raised by both the stakeholder as well as shareholder approaches. What follows is a description of the relevant features of the market failures approach, as well as a defense of the view as the best approach to normative business ethics.

Transaction Cost Economics is relevant to the market failures approach, which is the focus of this paper, in various aspects. Most noteworthy is the focus on the individual transaction when evaluating the acceptability of a business practice,
and the classification of activities as either market (external) or administered (internal) transactions, as explained below.

**Administered and Market Transactions**

It is important to understand that within an organization, there are many relationships, both external and internal, that are germane to its ongoing operations. Business ethics’ primary role is to dictate the moral behavior that the parties of these relationships ought to exhibit towards one another when transacting business. In the essay “An Adversarial Ethic for Business,” which is consistent with transaction cost economics, Heath goes a step further and makes the sharp distinction between “administered” and “market” transactions that organically occur in firms. Each category has specific relational characteristics and thus different requirements for a moral code. Administered transactions, which are internal to the firm, include both employees and shareholders (through the board of directors). These transactions are “organized as principal-agent relations, and are therefore governed by an essentially cooperative logic” (Heath 2007, 23). The parties involved in these transactions work collaboratively to advance the interest of the “principal”; therefore, the moral obligation is fiduciary in nature.

Market transactions, however, are negotiated by the price mechanism. They are adversarial transactions that are “governed by an essentially competitive logic” (Heath 2007, 23). The market, as well as sports and criminal legal procedures, are
deliberately adversarial institutions that “produce ‘positive externalities’ even where these were not intended or sought directly by the players in these competitive forums” (Norman 2011, 52). Given the adversarial nature of these institutions, the obligations and rights of those operating within such an environment differ from what one may consider the “norm.” For example, one would typically expect an ‘ethical person’ to be accommodating and cooperative, yet in business, cooperating or “colluding” is illegal because it negatively affects the efficiency of the market and thus creates a market failure.

This categorization of business transactions as either administered or market is significant and is key to the proper formulation of a moral code, as the nature of the transaction determines the character of the associated obligation. “Thus the difference in character of the moral obligations that managers owe to different individuals who are affected by the actions of the firm depends upon the nature of the transactions that occur between them, and in particular, whether these transactions are mediated through the price mechanism” (Heath 2007, 22). The graphic below depicts administered and market transactions and their associated characteristics.
This explicitly implies that for-profit organizations seeking to integrate ethics into the business operation must utilize a two-pronged approach—one to accommodate the cooperative relations of administered transactions, and another to address the adversarial relations of market transactions. (Earlier, this chapter highlighted other approaches to business ethics that may be suitable for administered transactions; however, such discussion is beyond the scope of this paper.) The remaining sections of this chapter focus on the Market Failures approach to business ethics and will center on market transactions in particular.

A common perception of profit-seeking businesses today is one of organizations that have but one purpose—advance the firm’s interest through the maximization of profits. Both profit-maximization and self-interest are commonly regarded as synonymous and as equally immoral. Given this line of reasoning, it is
easy to understand why many think of business ethics as an oxymoron. After all, morality is thought to require a certain degree of constraint on self-interested actions; this is incompatible with the presumed goals of business. This misunderstanding has led to confusion and the dismissal of any ethical theory that justifies profit maximization. Further, failure to distinguish between self-interest and profit-maximization has stigmatized corporations merely for their desire to generate profit. In the essay, “A Market Failures Approach to Business Ethics,” Joseph Heath makes a case for the justification of profits and clarifies the jejune association between profit maximization and self-interest that remains the predominant view.

**Justification of Profit-Maximization**

Heath posits the notion that profit-maximization is a managerial obligation as well as an effective tool for the development of an ethics. “Profit-maximization, understood as an obligation, rather than as an expression of self-interest, provides a perfectly legitimate platform for the development of a robust moral code” (Heath 2014, 26). One must first understand that profit-maximization is a managerial obligation and not a manifestation of self-interest. A manager is not identical to his or her firm, after all. In fact, a manager’s self-interest may sometimes conflict with the interest of her firm. So the obligation to act in the interest of the firm is not always a requirement that he or she act in his or her own interest. Just as a
doctor’s obligation to his or her patient supersedes any self-interest, so does the professional manager’s obligation to the shareholders supersed his or her own self-interest.

The moral obligation a manager owes the shareholders is based on a principal-agent relationship and thus is fiduciary in nature. As such, the manager has an obligation to maximize profits on behalf of the principal. This obligation, however, does not in any way suggest that a manager may seek to maximize profits at any cost and by any means. Rather, the obligation is to maximize profit by operating within a given set of constraints. This line of reasoning forms the basis of Heath’s Market Failures Approach to business ethics.

One impediment to the serious consideration of a profit-maximizing business ethics framework has been the difficulty in justifying profits. Unlike goals such as maintaining good health (the objective of healthcare professionals), which is inherently good and should be sought, profit has questionable intrinsic value. In fact, profit-seeking often results in actions that are morally problematic, e.g.; reducing non-billable staff in order to cut costs and increase profitability for the owners; downgrading employee health benefits to cut costs and increase profit; or eliminating cost-of-living adjustments, to name a few. Heath likens this situation to that of the trial lawyer in that “the adversarial trial system imposes upon lawyers an obligation to do whatever is in their power to defend or advance the interests of
their client, even when these interests are highly refractory to the concerns of justice” (Heath 2014, 28). The obligation to the client, or principal in the case of the manager, is such that it trumps self-interest. The lawyers must pursue the case vigorously, fully understanding that the outcome of the interaction between parties, prosecutor and defense, justifies their conduct. Likewise, the manager must manage resources by pursuing any permissible profit strategy to ensure profit-maximization for the principal. “What justifies their behavior is the fact that they operate in the context of an institution with differentiated roles. The desirable outcome is a product of the interaction between individuals acting in these roles, none of whom are actually seeking that outcome” (Heath 2014, 28). Thus, the justification of the result is therefore indirect rather than direct. The good outcome is not what parties within adversarial contexts aim towards, but is an anticipated outcome of each party functioning as an agent on behalf of the interests of the principal.

The Profit Motive

The profit-seeking firm has a distinct role to perform, as it is an integral part of the market economy. Specifically, “the primary reason for introducing the profit motive into the economy is to secure the operation of the price mechanism ... [which] is in turn valued for its efficiency effects” (Heath 2014, 29). It is the price mechanism that efficiently allocates resources and reduces waste. In a situation
where there are multiple buyers and sellers, it is the interaction between the two groups that drive prices to the point that clears the market, resulting in efficient resource allocation. Profit is the incentive for corporations to competitively engage in market transactions. For this reason, Milton Friedman refers to the non-shareholder-focused view as a doctrine that undermines free economy. He contends the only social responsibility for managers that is clearly defined and easily institutionalized is the obligation to generate maximum profit for the shareholders. An expansion of that obligation to society or social interest in general becomes problematic because it is too broad and too vague to be institutionalized into the structure of the firm. Friedman declares:

If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest?" (Friedman 1982, 113)

Clearly, assessing and evaluating social interests is outside the purview of the role of the typical corporate manager. Requiring them to function in this capacity is a misalignment of skills with responsibilities — a misallocation of resources.

As discussed earlier, ethicists have been reluctant to seriously consider an ethics based on profit maximization because of the prevailing, yet erroneous association between profit maximization and utility maximization of managers. In the text entitled *Capitalism and Freedom*, Milton Friedman posits his shareholder-
focused ethics in his discussion of the social responsibility of business in a free economy. He states, “In such an economy, there is one and 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” (Friedman 1982, 112). Friedman explicitly implies businesses must engage in its operational activity within the restrictions imposed by free competition and the absence of deception or fraud. That is, businesses may engage in profit-maximizing strategies, subject to specific, rigorous constraints. Such constraints underpin a business ethics based on profit-maximization.

The obligation that the managers have to the shareholders is fiduciary in nature, viz. they are operating on behalf of the shareholders to help generate a return on their investment to which they are entitled based on the first fundamental theorem of welfare economics (FFT). This relationship involves trust and moral constraint on the part of the manager, who holds a position that affords him or her the opportunity to exploit the relationship for personal gain. The constraint involving deception and fraud has legal and moral ramifications. That is, fraud is illegal, so obviously one is bound by law to refrain from fraudulent activity. Deception, however, is not illegal. “The problem with deception is that it violates one of the conditions needed for the economy to achieve an efficient outcome. It is
these conditions that Friedman is adverting to as well when he talks about an obligation to engage in ‘free and open’ competition” (Heath 2014, 33). Lying to consumers about the goods or services they are acquiring affects the price of the exchange; so that it does not reflect the actual need for those goods or services. This generates market inefficiencies, or what economists call “market failure.”

The graphic below depicts Friedman’s normative framework, which reflects a categorization of profit-maximizing strategies as acceptable, immoral, or illegal based on the efficiency standard of the market system. Unacceptable strategies are further categorized as immoral or illegal using a transaction cost or regulatory cost analysis (Heath 2014, 35).

<table>
<thead>
<tr>
<th>Profit maximization strategies</th>
<th>Acceptable</th>
<th>Immoral</th>
<th>Illegal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Examples</td>
<td>lowering prices, improving quality</td>
<td>pollution, deceptive advertising</td>
<td>fraud, theft, embezzlement, false advertising</td>
</tr>
</tbody>
</table>

Figure 3.5. Friedman’s normative framework. Illustration from Heath 2014, Figure 1.1.

In his essay, “A Market Failures Approach to Business Ethics,” Joseph Heath further refines Friedman’s framework and unveils a system of normative ethics that is based on the market economy. Heath defines business ethics as a “set of additional constraints that preclude legally permissible, but not normatively justifiable, profit-maximization strategies” (Heath 2014, 26). He explains that under this approach, the only way a firm can make a profit is to engage solely in
“preferred” or permissible profit-maximizing strategies, even though other strategies may be available. Therefore, “according to the market failures perspective [for business ethics], specifically ethical conduct...consists in refraining from using non-preferred strategies to maximize profit, even when doing so would be legally permissible” (Heath 2006, 550).

Market Failures Approach to Business Ethics

Thus, using the first fundamental theorem of welfare economics (FFT) to underpin his method, Heath lays the foundation for a profit-focused approach that emphasizes the manager’s obligation to maximize profit within established constraints. A perfectly competitive environment would place onerous restrictions on businesses’ profit-maximizing strategies and impose imperatives, such as:

1. Minimize negative externalities.
2. Compete only through price and quality.
3. Reduce information asymmetries between firm and customers.
4. Do not exploit diffusion of ownership.
5. Avoid erecting barriers to entry.
6. Do not use cross-subsidization to eliminate competitors.
7. Do not oppose regulation aimed at correcting market imperfections.
8. Do not seek tariffs or other protectionist measures.
9. Treat price levels as exogenously determined.
10. Do not engage in opportunistic behavior towards customers or other firms. (Heath 2014, 37)

One must bear in mind that the Pareto conditions outlined above express how businesses should conduct themselves in a perfectly competitive market, which is an idealization. The point is to highlight the rigorous constraints that are
inherent in a true free-market economy. Heath makes it clear that “in the real world, any firm that began to unilaterally respect these constraints would be quickly eliminated from the marketplace” (Heath 2014, 37). If small-business government contractors were required to compete solely through price and quality, the business development function that is so crucial today would immediately become obsolete. Calling on customers or potential customers to make introductions, demonstrate products, and acquire information about upcoming bid opportunities would impose deadweight losses on the economy because of the non-productive nature of the activity, similar to advertising. Further, such constraints would be problematic for small businesses because they would effectively eliminate small-business and socio-economic set-aside programs, which afford small businesses the opportunity to compete among themselves for government business. These programs would not be permissible as they restrict competition and create market failure.

The crux of Heath’s market failures approach to business ethics is that one can develop a robust moral code from the notion that the fundamental obligation of managers is to maximize shareholder value. An “ethical manager is one who does so while respecting not only the letter of the law, but also its spirit – which is to create the conditions necessary for private enterprise to generate an efficient allocation of goods and services in the economy” (Heath 2014, 39). Wayne Norman
provides a clear synopsis of the rationale behind this approach, which is,

“Governments try to prevent market failure that would allow firms to make a profit without contributing to the efficiency properties of the market; and where they cannot, firms have an ethical, beyond-compliance, obligation to avoid creating or exploiting market failures themselves” (Norman 2011, 51). Therefore, the ethical manager maximizes profit within constraints that are beyond compliance with the law.

Heath concedes there are challenges facing his approach to business ethics. The FFT stipulates conditions under which pareto optima can attain; however, as it is a mere idealization, such conditions are not achievable in reality. The second-best theorem further complicates the situation in that it states the violation of any one Pareto condition may result in a worse outcome than would occur if multiple conditions were violated:

It is well known that the attainment of a Paretian optimum requires the simultaneous fulfillment of all the optimum conditions. The general theorem for the second best optimum states that if there is introduced into a general equilibrium system a constraint which prevents the attainment of one of the Paretian conditions, the other Paretian conditions, although still attainable, are, in general, no longer desireable. (Lipsey and Lancaster 1956, 11)

As it stands, the application of this approach as a normative framework suggests that ethical behavior could have undesirable results for companies or society as a whole, if even one constraint is violated. Heath addresses this issue by
removing the focus from appealing to the economy as a whole, and drawing attention to the efficiency gains that each firm achieves through market exchanges. In this “bottom-up” approach, managers and shareholders function as custodians of productive resources that will ultimately be used to fulfill human need. “Thus the firm purchases a bundle of productive inputs in order to satisfy these needs, and profit – when earned under the correct conditions – is the reward that is enjoyed for having done a better job at satisfying these needs than any of its rivals” (Heath 2014, 41). Heath asserts this perspective allows the justification of all the Pareto conditions listed above, which would “function as a set of heuristics, allowing us to determine what sort of conduct, in general, is likely to constitute an illegitimate source of gain” (Heath 2014, 41).

The concept of utilizing the Pareto constraints as a set of heuristics to guide or filter moral decisions within the business context is key to the development and implementation of a code of ethics founded on profit-maximization. Heuristics refer to the cognitive short cuts or rules of thumb that one may access consciously or unconsciously to “expedite,” if you will, the decision-making process. This is particularly relevant to a discussion of Dan Ariely’s empirical studies on moral behavior earlier in this chapter. His work concluded that a moral reminder is a proven effective approach to decreasing dishonesty. He found that persons were less likely to be dishonest when they had access to reminders about their moral
obligations. For example, students tended to refrain from cheating when an honor code was posted in the room. One can argue that the presence of the code served as an availability heuristic that guided their decision not to cheat because it reminded them of their commitment to honesty.

**The Market Failures Approach: Relevance to the FAR Ethics Requirements**

Heath asserts the Pareto conditions can be used as a set of heuristics within an appropriate framework. Within the context of this project, it suggests the Pareto constraints could underpin the business code of conduct that the FAR requires. The company would then disseminate, promote, and inculcate this robust code into its culture. As such, a manager faced with a moral decision involving market transactions, would have ready access to mental short cuts (availability heuristics) that would assist in the prompt determination of the permissibility of a given activity. An excellent example would be a manager’s refusal to accept confidential, source-selection information regarding an active bid that an employee acquired from a Government “connection” within the acquisition shop. The manager should be able to intuit immediately that this activity undermines competition and therefore is not permissible.

This paper posits the idea of using the market failures approach as a beyond-compliance measure to align the small business contractor’s ethics efforts with the government’s ethics agenda, and thus satisfy the requirements to achieve
compliance with both the letter and spirit of the FAR amendment. The graphic below depicts the application of the Market Failures Approach to business ethics within the framework of the FAR as presented earlier in Chapter 2.

Figure 3.6. Market Failures Approach within the FAR high-level framework.

The overarching structure of the FAR supports the requisite policies and procedures, standards of conduct for government personnel, and contractor requirements to ensure acquisition activities are geared towards promoting fair competition. The Government realizes the value of competition as a means to efficiently allocate resources; thus, the goal of the FAR system is to increase efficiency in the purchase and delivery of quality goods and services by promoting fair competition among ethical industry partners.

The market failures approach has a place of primacy in its suitability to facilitate the alignment of the small business contractor’s ethics goals with those of
the government, as espoused in the FAR. It clearly offers advantages that other methods cannot. First, the approach is consistent with principles that underpin the free market and thus, fair competition. It focuses solely on market transactions and addresses the adversarial nature of competition by appealing to a set of constraints that restrict or limit certain activities. Wayne Norman states “it is an ethics tailored specifically for an institution (the market) that has been designed to be deliberately adversarial. . . . Rather than anointing one firm to provide goods and services, we invite multiple firms to enter an arena in which they compete with one another to provide the products or services” (Norman 2011, 51).

The FAR, the regulation that directs government acquisition activity, is concerned only with market transactions — financial transactions between the government and contractor. Therefore, the requirements and prescription address contractual dealings between these two parties. The market failures approach is intentionally structured to pertain to market transactions only, and in this context would only relate to the activity between government and contractor for which the FAR has oversight. Other methods do not distinguish between market and administered transactions; therefore, they do not offer a specific approach to address the adversarial nature of market dealings.

Similar to the FAR, the main objective of the approach is to promote fair competition (increased efficiency) and eliminate or mitigate market failures. The
FAR ethics provisions include the requirement to detect and report criminal activity related to the procurement process. Further, the market failures approach provides the requisite framework for the development of a robust code of conduct that is aligned with the FAR because it is based on fair competition.

The new ethics provision of FAR clause 52.203-13 requires small businesses to develop and promote compliance with a corporate code of business ethics, yet it provides no guidance on the content of the code. It is noteworthy that the FAR requirements clearly relate only to market transactions, as discussed above, yet the regulation does not direct the contractors to ensure they address market transactions when formulating the code. If the code is silent in this regard, it will not align with the government’s objectives and could prove to be a futile exercise for many small businesses. As discussed in Chapter 4, one of the comments from the FAR Council indicated that most companies have some form of code of conduct, so this mandate should not prove burdensome to small businesses. The problem here is that a company could very well have a code of conduct and implement it and still be non-compliant with the spirit of the regulation because the code may fail to address the type of issues that create the very market failures that the new regulation is trying to correct or prevent.

Further, as a practice, most companies, particularly small, have only one code of business ethics (if any) and it often covers only administered transactions. That is,
transactions internal to the firm. The FAR is not at all concerned with corporate governance structure – viz. the relationships and conduct within the hierarchy of the firm.

The rule specifically states that the requirement for a code is procurement-specific, meaning it is only in effect during the term of an awarded contract. One can make a case that the code of ethics to be generated by the contractor should align with the spirit of the law and the regulation as amended. It should promote fair practices to foster a competitive environment that benefits the government, the small business community, and society as a whole. The market failures approach is uniquely suited to underpin this type of code of ethics.

Summary

The Market Failures Approach is an ideal theory to underpin a business code of conduct for small-business government contractors because its tenets align well with the objectives of the ethics provisions of the FAR as amended. At a very high level, the government amended the FAR to incorporate ethics requirements in an effort to:

1. Detect criminal activity related to the procurement process. Criminal activity includes kickbacks, bribes, overbilling, etc. All focused on the ensuing contract for services or products, viz. market transactions. (Criminal activity is covered through law; violators are subject to punishment commensurate with the offense. The FAR asks that contractors be diligent in their effort to promptly identify this type activity.)
2. Reduce fraud, waste, and abuse. Again, overbilling or other fraudulent activity related to the procurement process. (market related)
3. Ensure fair competition. Eliminate unfair advantage such as gaining access to solicitation-sensitive material or engaging in collusion, which would create information asymmetry and undermine competition. This would result in a market failure.

The market failures approach addresses market transactions and promotes competition, which are two key objectives of the FAR amendments.
CHAPTER 4

RESEARCH METHODOLOGY AND FINDINGS

Study Context

Recent changes to the Federal Acquisition Regulation (FAR) reflect the government’s resolve to rein in contractors and reinforce the long-established policy requiring the government to conduct business only with contractors having a “satisfactory record of business ethics and integrity.” The government is executing its ethics agenda, aimed at raising the ethics bar for contractors by incorporating rigorous requirements for the establishment of a code of ethics, an ethics program, internal control system, and ethics training for employees.

The flurry of activity surrounding federal acquisition policy is significant and certain to impact the small-business, government-contracting community. The recent measures the government has taken to promote ethical and lawful business practices are major and demonstrate a transformation in the government’s approach to addressing the ethical conduct of its industry partners. This shift from non-involvement to total engagement sends the clear message to contractors that it is time to get their house in order (particularly as it relates to ethics) or risk debarment or suspension.

The new FAR clauses, however, only require small businesses to develop a written code of ethics for dissemination to contract employees, disclose any
detected criminal activity associated with the procurement in a timely manner, and “otherwise promote a culture that encourages ethical conduct and commitment to compliance with the law” (with no definition or guidance on how to accomplish these objectives). Small business entities are not subject to provisions mandating the development of compliance and ethics programs that incorporate internal controls and processes for detecting and disclosing unethical business behavior. The government elected to exempt small-business contractors from the more stringent ethics requirements of the FAR out of consideration for their limited resources and the financial burden associated with compliance.

The FAR activity surrounding the ethical conduct of government contractors and its impact on small business contractors is the focus of this study. Specifically, the study's primary objectives are to ascertain small-business government contractors' perception of how new ethics requirements within the FAR will impact their business operations and ability to comply; and to obtain the opinion of members of the target community regarding the government's more "intrusive" approach to controlling contractor conduct, that is, the move from self-regulation to contractual prescriptions.

**Methodology**

The researcher implemented a three-pronged approach to garnering information to inform the doctoral thesis. The first two components consist of a
survey study and focus group, both having small-business government contractors as the targeted population. This portion of the research protocol received approval from Georgetown University’s Institutional Review Board (IRB). The study, entitled Ethics Requirements of the Federal Acquisition Regulation (FAR): Impact on Small-Business Government Contractors, qualified for expedited review because the potential risks of harm associated with the study were minimal, that is, they presented no greater risk to the participants than those typically encountered in daily life. (A copy of the official letter of approval is located in Appendix A.) The third element in this approach entails a thorough review of the Federal Register’s documented public comments from industry and government regarding proposed changes to the FAR to incorporate FAR Clause 52.203-13, Contractor Code of Ethics and Business Conduct. Each method contributed valuable insight (from a small business perspective) into the issue of compliance with the new ethics requirements, as well as the potential impact change might have on the small business community.

Study design

In this study, the research methods included both survey research and a focus group study. Initially, the target population consisted of small-business government contractors with less than 500 employees and revenue in excess of $5 million averaged of over a three-year period. The researcher, however, chose
to broaden the scope to include companies below the $5 million threshold, as it became evident that applying the 3-year average as criterion unnecessarily limited participation of companies large enough to compete for government contracts in excess of $5 million that would incorporate the new FAR clause. The goal of this study was to determine, among other things:

- The small business’s perception of the new ethics requirements and the government's move away from self-regulation to contractual prescriptions
- The reasonableness of the requirements and the firm's ability to comply
- The company's current ethics efforts (ethics program)
- An assessment of the company's current program
- The small business’s perception of the value of establishing a code of ethics
- The firm’s opinion of beyond-compliance
- The possibility of an over-justification effect
- The company’s view on the sincerity of the Government’s ethics agenda

The researcher opted to conduct an Internet survey using Survey Monkey as the automated tool, fully understanding that this approach might not be suitable for the general population. However, the study’s target population, which was limited and well defined, produced reliable results. As a sampling method, the researcher utilized non-probability sampling; the sample is not representative. The strategy to use a non-representative sample was due to two primary factors. First, the population was very large (in excess of 4,300 contractors meeting the criteria); and second, the researcher anticipated a low response rate because of

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1 FAR Clause 52.203-13 only applies to certain contract awards in excess of $5.5 million.
the sensitivity of the topic, the exclusivity of the invitation (owners/senior management only), and the opportunity cost of the time required to complete the survey. While the participation rate is low, the quality of the responses from the small sample is superb.

The researcher used the Small Business Administration’s (SBA) dynamic-search database of small businesses to obtain email addresses of potential survey participants. The quality and accuracy of the data were excellent; the database identified senior management and provided reliable contact information, as evidenced by a very low bounce rate for the email addresses. Other design and implementation strategies within the survey approach included:

1. Designing the survey so that the invitation could not be forwarded (Only the recipient could complete the survey.)
2. Maintaining consistency in language between the survey invitation, the follow-up email correspondence, and the actual survey to minimize confusion
3. Entering participants in a weekly drawing for a $150 gift card to increase participation
4. Sharing of limited results with respondents as an incentive to participate
5. Sending the email invitation very early in the mornings so it arrives at the top of the recipient’s email inbox
6. Limiting the survey to 20 minutes
7. Ensuring confidentiality of individual responses
8. Identifying and mitigating any risk (Author’s list)

The researcher monitored the survey results daily and sent out a weekly reminder to those who had not responded in an effort to increase participation. The survey closed its data collection activities after 30 days, but remained open
for accrual for an additional 30 days. The total study duration, including data analysis was approximately three months.

Additionally, the researcher conducted a focus group consisting of executive managers of small-business government contractors. The original protocol called for assembling three focus groups; however, persuading small-business owners and executives to sacrifice their coveted time to participate in a study proved to be an insurmountable challenge. The one focus group that participated consisted of three local small-business government contractors currently performing on government projects.

The focus group meeting took place in a private conference room with a table and comfortable chairs. Food and beverage were available. The researcher asked each participant to read and execute a consent form. Upon receipt of the executed consent forms, the researcher functioned as the moderator and presented the eight questions to the participants from a prepared script. As facilitator, the researcher encouraged participation from all group members and managed group dynamics. An assistant, who was not engage in the study, provided administrative support such as note taking and audio recording the session. The researcher informed the group right up front that the session was being audio recorded and confidentiality would be maintained in the ensuing report. The session lasted for approximately two hours, including the meal.
Risks and Mitigation

The study is an integral part of the doctoral thesis, whose goal is to provide an alternative approach to business ethics for small-business government contractors to ensure compliance with contracting ethics regulations. This would benefit the community as a whole, and companies without a code of ethics in particular. Therefore, risks associated with the study were minimal. Admitting that one's company did not have a documented code of ethics presented some level of risk because it could have suggested non-compliance with a federal contracting provision. The probability of harm would have been very low, however, because the harm could have only occurred had the contracting officer by some means received this information about a particular company and readily associated that company with a specific contract that contained the ethics provision. Although the probability of this occurrence was remote, the researcher still mitigated the risk by restricting participation to non-government personnel and not disclosing participant-company names.

The researcher minimized research-related risks by maintaining confidentiality throughout the study for participants in both the survey and the focus group. In the unlikely occurrence of an adverse event, the researcher would have followed protocol and immediately informed the Department and reported the event to the IRB via the eRIC system.
Informed Consent

The researcher designed the survey with the consent form as the first page and its acceptance as the first question. Refusal to accept the terms of the form would cause the survey to end immediately, as consent is a requirement of the research protocol. The survey participant had up to 30 days to complete the survey, which was more than adequate time to ponder the terms of the consent form and make an informed decision.

For the focus group, the researcher distributed a copy of the consent form in advance to allow sufficient time for the participants to review its terms. Prior to the beginning of the session, the researcher’s assistant distributed the consent form to the participants for signature. All study participants were at least 18 years of age; there was no coercion or undue influence.

Privacy and confidentiality of data

The researcher thoroughly understands the significance of protecting the privacy of the participant and ensuring confidentiality of data. As such, the researcher has shared only a limited data set of the results: the aggregate data for the doctoral thesis, and select summary data from the survey reports for participants (as an incentive to participate, in addition to the chance to win a $150 gift card in weekly drawings).
The researcher maintained confidentiality throughout the study for participants in both the survey and the focus group to mitigate research-related risks. For the survey, the researcher exercised diligence in ensuring the privacy of participant data by using a survey tool that transmitted data via a Secure Socket Layer (SSL) environment so as to protect Internet Protocol (IP) addresses and Personal Identifiable Information (PII). The researcher assigned unique numbers for all participants as identifiers instead of company or individual names, and used these identifiers during data collection, storage, analysis, and reporting. The key linking the numbers to the identifiable data is contained in an encrypted EXCEL spreadsheet and stored on a secure server. Only the researcher has access to the data.

For the focus group, confidentiality presented a greater challenge because the researcher could not guarantee the confidentiality of information shared within the data collection setting. However, the researcher stressed the importance of maintaining the confidentiality of the shared information and asked participants not to discuss the content outside the collection environment. To help mitigate research-related risk, the researcher did not use actual names of individuals and companies during the session. Instead, she assigned a unique number to each person, and used the identifiers during data collection, storage, analysis, and reporting. Only the researcher has access to the key linking the
numbers to the individuals, which is stored in an encrypted file on a secure server.

The researcher will retain the data for three years, after which time she will destroy the information using one of two methods. In the case of electronic data stored on hard drives, the researcher will use secure-erase software to clean the data from the drive. For hardcopies and electronic data stored on CDs or audio tapes, she will use a professional secure shredding service to destroy the data.

**Research and Analysis of Public Comments**

This section of the chapter analyses pertinent comments resulting from the promulgation of a rule to amend the FAR to address the requirements for a contractor code of business ethics and conduct, as presented in case 2006-007. The procedures for amending the FAR dictate posting proposed changes in the Federal Register; extending a 30-day period for comment from interested parties in industry and government; and rendering a response from the FAR Councils following the review and consideration of the comments. The comments are an integral part of the research project, as they influenced the formulation of the expected outcomes of the research study. The final rule, which resulted in the establishment of FAR clause 52.203-13, is the focal point of the research, as it details the ethics provisions that are mandatory for small-business government
contractors subsequent to the application of specific exceptions and exclusions based on the size of the entity.

The FAR Secretariat received 43 comments regarding the first proposed rule in case 2006-007, and 25 in response to the second proposed rule, case 2007-006; however, 15 respondents posted comments on both rules. Therefore, there were a total of 53 respondents, 18 of which represented government agencies (U.S. DOD, GSA, and NASA 2008)

The comments are divided into five categories: General support for the rule; General disagreement with the rule as a whole; Broad recommendations; Contractor program requirement; and Exceptions—general. An analysis of the comments is beneficial to the project because it provides a clear depiction of both industry’s and government’s opinion regarding the implementation of the rule, as well as their perception of the rule’s implications within their own individual context.

Table 4.1. Comments in general support for the rule

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Council’s Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>The majority of respondents supported the rule. These included consultants, industry associations, a non-profit contractor, a construction contractor, inspectors general and interagency IG working groups, other Government agencies, and individuals. – Received comments of “outstanding”; laudatory of the rule.</td>
<td>Perceived benefits of the rule:</td>
</tr>
<tr>
<td></td>
<td>• Reduce contract fraud</td>
</tr>
<tr>
<td></td>
<td>• Reduce waste, fraud, abuse ad mismanagement of taxpayers’ resources</td>
</tr>
<tr>
<td></td>
<td>• Enhance integrity in the procurement system by strengthening the requirements for corporate compliance systems</td>
</tr>
<tr>
<td></td>
<td>• Promote clarity and Government-wide consistency in agency requirements.</td>
</tr>
</tbody>
</table>

Under the first category, General Support for the rule, the majority of interested parties responded positively to the rule primarily because of the perceived potential efficiencies that could be accomplished through such a mandate. Fraud reduction, integrity improvement in government acquisitions, and standardization of requirements across government agencies are the noted benefits. However, an important factor that is not evident in the documentation is the composition of respondents in terms of entity type, that is government contractor small or large vs. private industry small or large. While the majority favors the rule, it stands to reason that the minority may very well include small businesses, based on discussions under subsequent categories that show strong dissension for the rule, particularly as it affects small business. Typically, small businesses lack the resources to actively engage in matters of public policy because of competing priorities within the business. As such, it is likely that many small businesses were not aware of the proposed changes and accordingly did not participate in the discussion process. The comments and discussion above support the researcher’s first assumption or expectation of the survey study:

1. *Many small businesses are not aware of the amendment to the FAR that implements clause 52.203-13.*

Under the next category, General disagreement with the rule as a whole, there is substantially more energy focused on the faults, shortfalls, and futility of the rule than seen in the prior category. Essentially, there are eight general
complaints that form the basis for the respondents’ objection to the new rule. The table below highlights those comments from respondents.

Table 4.2. Synopsis of comments in general disagreement with the rule

<table>
<thead>
<tr>
<th>Complaint Regarding Rule</th>
<th>Comments from Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ineffective</td>
<td>The rule is insufficient to correct business conduct improprieties. A written code of ethics does not ensure compliance with its provisions.</td>
</tr>
<tr>
<td>2. Unnecessary or duplicative</td>
<td>Respondents indicate the new requirements are duplicative or requirements mirror those by which many contractors are statutorily or contractually obligated. The duplication of requirements for the same purpose can cause conflict.</td>
</tr>
<tr>
<td>3. Vague and too broad</td>
<td>Several respondents consider the rule too vague and broad, which opens it to different interpretations.</td>
</tr>
<tr>
<td>4. Negative effect on current compliance efforts</td>
<td>Respondent believes the rule could have a “chilling effect” on current efforts.</td>
</tr>
<tr>
<td>5. Change in Role of Government</td>
<td>Respondent fears rule will “fundamentally change the government’s role in the design and implementation of contractor codes and programs” because it moves from “the well-established principles of self-governance and voluntary disclosure” to “contractual prescriptions and potentially mandatory disclosure.” The proposed rule is more than a minor modification of existing policy, but would change far more than the FAR Councils have acknowledged.</td>
</tr>
<tr>
<td>6. Unduly burdensome and expensive for contractors</td>
<td>This will be a disincentive to doing business with the Government.</td>
</tr>
<tr>
<td>7. Difficult to administer for Government</td>
<td>Several respondents consider the rule expensive and impractical to administer. Another questions whether this rule can be effectively administered, as it will produce increased paperwork for contracting officials.</td>
</tr>
<tr>
<td>8. Rule should be withdrawn and redrafted</td>
<td>Several respondents asked for a redrafting of the rule with significant changes.</td>
</tr>
</tbody>
</table>

In the following pages, the researcher presents a comprehensive examination of the comments and discusses their implications. The ensuing analysis takes into consideration each of the complaints detailed above, paired with the respective comments from the FAR Councils.

Table 4.3. Comments in general disagreement with the rule due to ineffectiveness

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ineffective. The rule is insufficient to correct business conduct improprieties. A written code of ethics does not ensure compliance with its provisions.</td>
<td>• No law or regulation can ensure compliance. The intent is to provide a standard against which to measure actions and identify consequences for violations.</td>
</tr>
</tbody>
</table>


While the respondent’s entity type is not disclosed, the first comment regarding the ineffectiveness of a code of ethics clearly pertains to small business; therefore, the respondent could be small business or a small business advocate. Businesses other than small are required to implement an entire ethics program, so the comment that emphasizes only the code portion is likely to be small-business oriented. In any case, the perception that the code in and of itself is ineffectual in influencing behavior leads one to determine that a code is not of great value in shaping moral conduct, and as a result, the requirement is pointless.

Unfortunately, the response from FAR Councils did little to refute the claim. The key element for effectiveness is the successful implementation of the code in the business context. As discussed in Chapter 3, Dan Ariely’s empirical studies on human behavior determined whenever a code of honor or an
agreement documenting a commitment was present and used as a moral reminder, the study subjects were less likely to cheat. If there is a true correlation here, then one could surmise that merely having a code of conduct without inculcating the provisions into the culture (making it “visible”) significantly limits its effectiveness. In accordance with the above, the researcher devised the following assumption for the survey study:

2. *Small businesses will consider the requirement to have only a code of conduct to be ineffective.*

Comments two and three both allude to concerns regarding the inability to comply due to a lack of clarity and guidance within the rule itself, as depicted in the table below.

Table 4.4. Comments in disagreement with the rule due to redundancy

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
</table>
| 3. **Unnecessary or duplicative.** Respondents indicate the new requirements are duplicative or requirements mirror those by which many contractors are statutorily or contractually obligated. The duplication of requirements for the same purpose can cause conflict. | • The Councils are not aware of duplication of any existing requirements. Rule requires basic code of ethics and training for contractors. The Defense Federal Acquisition Regulation Supplement (DFARS) only recommends a code; it is not mandatory. This is the only government-wide, regulatory requirement for such a code.  
• Sarbanes Oxley pertains to accounting firms and publicly traded firms. It requires publically traded firms either adopt a code of ethics or disclose why they have not done so.  
• Since this requirement is broad and flexible, capturing the common essence of good ethics and standards of conduct, the Councils consider that it should reinforce or enhance any existing requirements |
The perception that the rule is redundant and thus unnecessary is owing to ethics requirements that exist in legislation or through contractual agreements that impact many businesses. For example, a government contractor conducting business with the Department of Defense (DoD) through a DoD contracting vehicle is subject to the rules of the DFARS, which is DoD’s implementation of the FAR with supplemental requirements that are peculiar to that agency. Although the FAR Councils state that this rule is the only government-wide requirement that mandates a code of conduct, the respondent anticipates the occurrence of conflict. As discussed in Chapter 2, when implementing the FAR, agencies, at their discretion, may supplement the requirements to meet the specific needs of the agency, provided that those requirements do not conflict with the regulatory framework of the FAR. The comment suggests the existence of potential conflict resulting from the new mandate.

The comment expressing the rule’s vagueness is another indicator that the lack of clarity could impede compliance because of a wrong interpretation of the requirements. The Councils’ response does little to satisfy the urging for clarity,
and instead, perpetuates the confusion by espousing “broad discretion” as a feature of the rule. The concern on the part of the respondent is that a company could develop a false sense of security believing that it is compliant with regulation when in actuality it is not due to a misinterpretation of the rule. Multiple respondents shared this concern.

The survey study poses three questions that pertain to the concerns raised in the two comments above. The researcher’s corresponding expectation is:

3. Small businesses will believe they are compliant with FAR provisions even though they find the requirements confusing and absent of guidance.

Comment four, which could pertain to either small or large business, introduces the possibility of an overjustification effect resulting from government’s endeavor to increase contractor’s compliance with business ethics requirements. The table below contains the comment and FAR Councils’ response.

Table 4.5. Comments in disagreement with the rule due to negative effect on compliance efforts

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Negative effect on current compliance efforts. Respondent believes the rule could have a “chilling effect” on current compliance efforts and possibly cause a fragmented approach to the standards of conduct.</td>
<td>• The rule should enhance current compliance efforts.</td>
</tr>
</tbody>
</table>


If a justification effect were to exist, it could adversely affect a company’s existing ethics awareness efforts. In such case, the extrinsic motivation (compliance with the mandatory regulation) could potentially undermine or stifle a company’s pre-
existing intrinsic motivation to establish an ethical business environment within
the organization because the intrinsic motivation would cease from being the
main catalyst driving the effort. For example, a small business that has chosen to
establish a formal ethics program with a complexity commensurate with the level
of resources the entity is able to invest, may decide to scale back its discretionary
investment to the point of mere compliance with the new rule that encompasses
specific ethics provisions that are considerably more limited than those already
being practiced within the organization. It is reasonable for a small business to be
susceptible to this type behavior because of limited resources and competing
priorities that are always commonplace within a small business organization.

The Councils’ response simply does not address the realistic scenario
presented above. One of the assumptions of the survey study that focuses on a
possible overjustification effect is:

4. Small businesses with existing ethics programs are likely to reduce their
efforts to the point of mere compliance with the rule.

Comment five expresses a concern (obviously from industry) that
government is overstepping its boundaries. First, it is mandating the
establishment of an ethics program (for businesses other than small), and second,
it is prescribing the program’s objectives and how such program is to be
implemented. The following table highlights the comments and response.
Table 4.6. Comments in disagreement with the rule due to the change in the government’s role

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>6. Change in Role of Government.</strong> Respondent fears rule will “fundamentally change the government’s role in the design and implementation of contractor codes and programs” because it moves from “the well-established principles of self-governance and voluntary disclosure” to “contractual prescriptions and potentially mandatory disclosure.” The proposed rule is more than a minor modification of existing policy, but would change far more than the FAR Councils have acknowledged.</td>
<td>• This rule does constitute a change. The Councils are requiring that contractors establish minimum standards of conduct for themselves. The rule allows for flexibility and contractor discretion. The “mandatory disclosure” requirement was deleted and will be addressed in case 2007-006.</td>
</tr>
</tbody>
</table>


The respondent takes issue with the rule because contractors have historically addressed standards of conduct internally through self-governance; government does not typically delve into a company’s internal affairs. Further, comments suggest prescribing the particulars of the plan—its contents and design—is intrusive. It appears the overall tone of the comments is one of suspicion.

The FAR Councils, in response, deny the rule constitutes any change; it simply requires minimal standards of conduct for contractors. However, the respondent perceives a sea change in the government’s approach to ensuring ethical conduct on the part of its contractors. Further, the comment raises a trust issue indicating the FAR Councils are unforthcoming in their acknowledgement of the magnitude of change the rule will effect. Clearly there is miscommunication between government and industry. The response, which is intended to clarify,
likely adds to the existing confusion. This occurrence is reminiscent of the early 1980s, as discussed in Chapter 2, when increased regulation caused a strain in government-contractor relations. As a result, companies began to seek more lucrative and less-encumbered opportunities in the private sector.

It is likely that the opinion of small businesses regarding the issue discussed above would diverge from that of larger businesses. That is, small business would not view the ethics requirements as an affront to their autonomy. Nor would they consider the government as interfering in their internal affairs because they are exempt from the more stringent business ethics requirements.

The assumption for the survey study, which aligns with this discussion, is:

5. Small business will not consider the government's action as stepping over the line.

Comment six raises the issue of increased regulation and its impact on government-industry relations. As discussed in Chapter 2, historically there has been an inverse relationship between increased regulation and industry's willingness to conduct business with the government, given a healthy economic climate. The comment and response are detailed in the table below.

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unduly burdensome and expensive for contractors. This will be a disincentive to doing business with the Government.</td>
<td>• Most companies have some form of ethics code. The rule has been changed to lessen the impact to small businesses.</td>
</tr>
</tbody>
</table>

The undercurrent here appears to be the burden of mandatory vs. discretionary compliance. It does not directly pertain to small business because the final rule has minimized the burden on small entities by requiring only a code of conduct. Further, a small business realizing the majority of its revenue from government sources is not typically in position financially or from an experience perspective to change its business model capriciously and enter the commercial sector. Thus, the small-business government contractor is typically limited to operating in the public sector. The expectation or assumption that resonates with this discussion is as follows:

6. *Increased regulation will not impact or minimally impact the small-business government contractor’s willingness to conduct business with the government.*

The respondent submitting comment number seven appears to represent government, as the concern centers on the impact the new rule will have on government staff, particularly contracting officers. Additionally, the comment questions the practicality of enforcement. The discussion is recorded in the table below.
Table 4.8. Comments in disagreement with the rule due to impracticality of administration

<table>
<thead>
<tr>
<th>Respondents’ comments</th>
<th>The Councils’ response</th>
</tr>
</thead>
<tbody>
<tr>
<td>8. <strong>Difficult to administer for Government.</strong></td>
<td>• There will be no increased burden of contracting personnel. The review of contractors’ compliance would be incorporated into normal contract administration. The Government will not be reviewing plans unless a problem arises.</td>
</tr>
<tr>
<td>Several respondents consider the rule expensive and impractical to administer. Another questions whether this rule can be effectively administered, as it will produce increased paperwork for contracting officials.</td>
<td></td>
</tr>
</tbody>
</table>


While the comment presents reasonable concerns, it is the response from the Councils that casts a shadow on the sincerity of the government’s ethics initiative. If there is no increased burden on the acquisition staff, as the response indicates, then one can assume there will be no change in the current workflow. Yet, the statement also says review of compliance will be conducted as part of normal contract administration. Currently, contract administration focuses primarily on the financial aspect of the contract—proper invoicing and cost containment—and on service or product delivery. Integrating an ethics compliance review into the process would be an additional workflow requiring additional workload or resources. The statement informs the community that the government will not review plans, including codes of conduct, unless there is an issue. It is evident that enforcement is not practical due to the sheer number of contracts and the limited number of contracting staff to verify and enforce compliance. Although the Councils advocate the necessity of moving away from discretionary compliance to a government-wide mandate for a code of conduct, in
practical terms, the inability to consistently enforce compliance renders it de facto discretionary. One of the assumptions of the survey research that relates to this discussion is as follows:

7. *Small businesses will have little confidence that the rule will be effective.*

The final comment in this section calls for a significant revision of the rule; however, the Councils only acquiesced in removing the mandatory disclosure from this rule and revisiting it under rule case 2007-006, hence, the second proposed rule.

Table 4.9. Comments in disagreement with the rule due to its need for redrafting

<table>
<thead>
<tr>
<th>Respondents’ Comments</th>
<th>The Councils’ Response</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>9. Rule should be withdrawn and redrafted.</strong> Several respondents asked for a redrafting of the rule with significant changes.</td>
<td>• Councils made some revisions in response to public comments. Republication is not necessary. But, mandatory Disclosure will be treated in new FAR proposed rule 2007-006.</td>
</tr>
</tbody>
</table>


Multiple respondents concluded that the rule as it stood could not be effective due to issues discussed above. It is not likely that the respondents’ conclusion about the unreasonableness of the rule reflects the opinion of small business, as they are exempt from many of the requirements. The researcher derived the following assumption:

8. *The majority of small businesses will conclude that the provisions of the rule are reasonable.*
The next category, Contractor Program Requirements, reflects comments from industry that focus on contractors’ concern about complying with ambiguous and vague requirements. Industry requested clarity and guidance from government to ensure their practices complied with the rule, as indicated in the table below.

Table 4.10. Comments regarding contractor program requirements

<table>
<thead>
<tr>
<th>Respondents’ comments</th>
<th>The Councils’ response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Lack of Specific Guidelines.</strong> Respondents want government to suggest minimum code of ethics and conduct. Vagueness places contractors at risk.</td>
<td>• Rule gives businesses flexibility to design their own program commensurate with their type of business and size. New FAR case 2007-006 will impose set of mandatory standards for internal control system.</td>
</tr>
<tr>
<td>2. <strong>Compliance.</strong> Several respondents question how the contracting officer will verify compliance with the requirements. There is no submission requirement.</td>
<td>• The contracting officer is not required to verify compliance, but may inquire at his or her discretion as part of contract administrative duties. Review of contractors’ compliance would be incorporated into normal contract administration. • The Government will not be routinely reviewing plans unless a problem arises. • The code of ethics is not a deliverable. • “What is important is that the contractor develops the code and promotes compliance of its employees.” • The contracting officer does not judge the internal control system, but only verifies its existence.</td>
</tr>
</tbody>
</table>


The first comment is from several respondents who inquired about the minimal requirements for a compliant code of ethics, as they felt the rule as stated was too vague. While the rule provided guidance for the other elements of an ethics program, it was silent regarding the specific requirements for a code of
conduct. Having a clear understanding of the standard and its implementation is essential to being able to comply. The response from the Councils failed to clarify, but instead reiterated earlier comments stressing the flexibility of the rule that allowed the contractor to design its own program. It appears industry was seeking guidance on how to align its code of conduct with the specific objectives of the rule; however, government was simply directing contractors to develop a generic code of conduct.

The second comment dovetails the first; that is, it questions the means by which the government intends to verify compliance, since the rule does not specify any submission requirements. The FAR Councils confirmed there are no submission requirements and no requirement on the part of the contracting officer to verify compliance. At his or her discretion, the contracting officer may inquire as to the existence of the plan or code but will not review it. It is clear the government will not enforce, yet compliance is mandatory. This ambiguity further exacerbates industry’s confusion.

Based on the above, one may question whether compliance is worth the effort since it is not enforceable. However, from the small-business government contractor’s perspective, one must exercise diligence in complying with all FAR provisions to mitigate the risk of debarment, which would essentially put that contractor out of business. Therefore, the small business contractor will interpret
the rule in accordance with its ability and comply with his or her understanding of the rule. The assumption for the survey study that incorporates this discussion is:

9. Small Businesses are concerned about their ability to comply with the rule.

The final category discusses exceptions provided for small business entities. The table below details the comments and responses.

Table 4.11. Exceptions to rule due to Regulatory Flexibility Analysis

<table>
<thead>
<tr>
<th>Respondents’ comments</th>
<th>The Councils’ response</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regulatory Flexibility Analysis</strong></td>
<td>The Councils acknowledge the difficulty and expense for small businesses to have a formal training program and formal internal controls. They also acknowledge that the public was confused about the proposed rule's flexible language for small business: “Such program shall be suitable to the size of the company.” As such, the Councils have maintained the clause requirement for small businesses to have a business code of ethics and provide copies of its code to each employee. There are many available sources to obtain sample code of ethics. The formal training program and internal control system are inapplicable to small businesses. Such provisions, however, would flow down to subcontractors if they were other than small.</td>
</tr>
<tr>
<td>Impact on small business requires regulatory flexibility analysis. The SBA Chief Counsel for Advocacy commented that the Councils should publish an initial Regulatory Flexibility Analysis. SBA indicated that the cost to set-up of an ethics program and internal control system would be approximately $10,000. System maintenance and ongoing training would be at additional costs. Other respondents asked for consideration due to the impact this mandate is likely to have on small business. Respondents also presented possible alternatives that would prove less burdensome on small business.</td>
<td></td>
</tr>
</tbody>
</table>


The issue is that the cost of developing an ethics program imposed a financial burden on small-business government contractors; therefore, the Councils were required to conduct a Regulatory Flexibility Analysis to determine the cost of compliance with the ethics requirements. At a price tag of $10,000 to set-up the program, respondents asked that small businesses be exempt from
having to comply with the provisions because of the financial burden. The FAR Councils complied and removed all ethics requirements in FAR Case 2006-007 except the requirement to have a code of conduct and disseminate it to all employees assigned to government contracts. As indicated above, establishing and maintaining a formal ethics programs is cost prohibitive for many small businesses. As a result, the researcher formulated the assumption:

10. Many small businesses do not have a formal organizational ethics program.

Research Study: Expectations and Assumptions

Review and analysis of public comments from the Federal Register that were in response to proposed amendments to the FAR shed light on industry’s opinion about the rule in general. Valuable discussion ensued between industry and government (as represented by the FAR Councils) that assisted in the formulation or validation of assumptions and expectations for the Survey Study that is discussed at length in the following section. The assumptions are as follows:

1. Many small businesses are not aware of the amendment to the FAR that implements clause 52.203-13.
2. Small businesses will consider the requirement to have only a code of conduct to be ineffective.
3. Small businesses will believe they are compliant with FAR provisions even though they find the requirements confusing and absent of guidance.
4. Small businesses with existing ethics programs are likely to reduce their efforts to the point of mere compliance with the rule.
5. Small business will not consider the government’s action as stepping over the line.
6. Increased regulation will not impact or minimally impact the small-business government contractor’s willingness to conduct business with the government.
7. Small businesses will have little confidence that the rule will be effective.
8. The majority of small businesses will conclude that the provisions of the rule are reasonable.
9. Small Businesses are concerned about their ability to comply with the rule.
10. Many small businesses do not have a formal ethics program due to the associated financial burden.

**Research Study: Survey Results**

The researcher sent out a total of 4342 survey invitations over the course of five days to small businesses listed in the SBA’s database that met the established criteria. There is high confidence that the data used to reach small business executives were accurate, as only 24 email invitations bounced back to the server. There were 42 email recipients that had previously opted out of participating in surveys facilitated through Survey Monkey; therefore they were pulled from the pool. A total of 106 recipients, or 2.4%, responded to the survey, which was far below the average response rate of 10-15% for external Internet surveys.² The number of non-responders totaled 4,171 or 96.1%.

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² Surveygizmo.com, an online survey tool, estimates a 30-40% average response rate for internal surveys and an average of 10-15% rate for external surveys. The large disparity is owing to the difference in the motivation level of the internal vs. the external audience.
The low response rate is owing to several factors. First, the small businesses extracted from the SBA database included commercial businesses as well as government contractors. Ideally, the researcher would have only invited government contractors; however, the database, with limited technical capability, did not allow a means to segregate the two business types. As a result, the extracted pool contained records in excess of the target audience, which skews the response ratios. While the database did not allow for filtering the source of revenue, it did allow filtering by revenue amount and number of employees, which were both components of the selection criteria. The researcher designed the survey to provide additional filtering through a question that asks for the composition of the business’ revenue sources.

The second reason for low response is likely due to the very nature of the topic—Compliance with the FAR. Compliance is a sensitive subject for contractors in general, and small businesses in particular because of the implications of non-compliance. Typically small businesses do not have the luxury of servicing a client base that is well diversified across industries; therefore, small-business government contractors are heavily invested in and dependent on government business to fund operations. Non-compliance, or even worse debarment, would essentially put the entity out of business. In the same way an Internal Revenue
audit is an unpopular topic to many people, discussing FAR compliance or non-compliance is unpopular to the small-business government contractor.

The third and final explanation for low response is likely attributed to the exclusive nature of the survey invitation. The researcher specifically targeted owners or senior executives of small businesses to receive the survey invitation, which was exclusive, meaning that the link to the survey would become invalid if forwarded to another email address. The researcher chose this approach because it allowed tracking, which produced a high level of confidence that the person completing the survey was the intended recipient. However, the downside to the approach was that it afforded only a single opportunity to solicit participation from a specific individual, who was likely the one responsible for running the business. Taking time to respond to a survey would detract from time that could be used otherwise engaging in productive activity. Although the survey invitation referenced a completion time of just 20-minutes, time is a valuable resource that executives are often not willing to forfeit, particularly for activity without apparent benefit to the company.

Notwithstanding the above, a total of 106 respondents entered the survey.
The following graph depicts the results of Question 1 of the survey, which inquires about participation.

As shown, 6 invitees opted out of participation presumably after reading the consent form, leaving a total of 100, who were willing to take part in the survey. The survey tool records the 6 non-participants as respondents that skipped all 20 questions; therefore, total respondents answering questions 2 through 21 will never exceed 100, and respondents skipping those questions will show a minimum of 6. There was no requirement to complete all questions in order for an entry to be accepted and included in the final results. As such, total number of respondents answering vs. skipping a question varies throughout the
survey. There were 89 respondents that completed the entire survey and 17 that partially completed the survey (including the 6 that opted out of participating).

The researcher chose to include data from incomplete surveys in the final results because she believes there is value in analyzing the trend in the types of questions that respondents may not be willing to address.

In the following analysis and discussion of the remaining 20 questions, the researcher grouped like questions by common theme. There are 5 groupings:

1. Company size and dependency on Government revenue - questions 2-5
2. New ethics requirements of the FAR — questions 6-8
3. Company’s existing ethics program — questions 9-11
4. Compliance with the FAR — questions 12-15
5. Opinion of Government’s policy change — questions 16-21

*Company size and dependency on Government revenue — questions 2-5*

The goal of the questions within this grouping was to provide additional filtering of the data extracted from SBA database to ensure respondents met the established criteria for the survey. The questions address revenue source and company size by revenue, personnel, and North American Industry Classification System (NAICS) code. The grouping also facilitates cross-tabulation with other questions so as to determine whether there are trends relative to the size and composition of the company’s structure and revenue. Businesses determined to be other than small based on the NAICS code, were removed from the data pool.
because they would not be exempt from compliance with all aspects of the new rule’s ethics requirements and thus would fall outside the scope of this inquiry.

Results indicate that 73.4% of respondents’ average revenue fell within the target range of $5 million to $35 million. Roughly 10.2% was below the range and 16.3% above. The researcher filtered for the target range; however, divergence could be a result of changes in the companies’ fiscal performance that had not been updated in SBA’s database. Companies with revenue in excess of $35 million
are included in the result throughout, provided they maintain a small business classification based on their NAICS code.

![Bar chart showing the percentage of annual revenue from government contracting.](chart.png)

**Figure 4.3.** Survey question 3: Revenue from government contracting.

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;10%</td>
<td>23.5%</td>
<td>23</td>
</tr>
<tr>
<td>10% - 49%</td>
<td>16.3%</td>
<td>16</td>
</tr>
<tr>
<td>50% - 80%</td>
<td>22.4%</td>
<td>22</td>
</tr>
<tr>
<td>&gt;80%</td>
<td>37.8%</td>
<td>37</td>
</tr>
</tbody>
</table>

*answered question 98
skipped question 8*

Question 3 had two objectives: 1) to establish how heavily a company depended on government contracts for business, and 2) to further filter the data to ensure respondents were government contractors. A total of 60.2% of respondents generated more than 50% of their sales in the government market, while 16.3% realized 10% - 49% in government sales. Those with less than 10% federal business (23 respondents) comprised 23.47% of the total. The researcher anticipated a relatively large value in this category because of the inability to
filter out commercial vendors that would report $0$ government sales. A cross-tabulation between this category and the FAR-specific questions in grouping 2 reveals that only 11 of the 23 respondents answered those questions and completed the survey. There is sufficient evidence to conclude that the remaining 11 vendors are indeed government contractors that generate revenue below the target range.

![Bar chart showing employee size distribution](image)

**How many employees work for your company?**

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 49</td>
<td>14.3%</td>
<td>14</td>
</tr>
<tr>
<td>50-99</td>
<td>43.9%</td>
<td>43</td>
</tr>
<tr>
<td>100-249</td>
<td>30.6%</td>
<td>30</td>
</tr>
<tr>
<td>250-500</td>
<td>5.1%</td>
<td>5</td>
</tr>
<tr>
<td>&gt;500</td>
<td>6.1%</td>
<td>6</td>
</tr>
</tbody>
</table>

answered question 98
skipped question 8

Figure 4.4. Survey question 4: Number of employees.

Question 4 as an independent factor has little value, as there is no direct correlation between size of company by employees and size by revenue. This factor is more interesting when cross-tabbed against other questions to look for
trends and relationships. For example, one can look at the respondents and determine if companies in the group are more likely to have an ethics program if they have more employees. Basically, this question's purpose is to facilitate analysis of other survey questions.

Based on your average gross sales over the past three years, is your company considered a small business under your primary NAICS code?

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>90.6%</td>
<td>87</td>
</tr>
<tr>
<td>No</td>
<td>8.3%</td>
<td>8</td>
</tr>
<tr>
<td>Unsure</td>
<td>1.0%</td>
<td>1</td>
</tr>
</tbody>
</table>

Based on your average gross sales over the past three years, is your company considered a small business under your primary NAICS code?

![Survey Question 5: Business Size](image)

The intent of this question was to filter out any company that was not considered small based on its primary NAICS code. While it is not unusual for a company to operate within several industry classifications, the SBA uses the primary code as the authoritative source to determine the company's size. Each NAICS code establishes the threshold for small business consideration within the
respective industry by either the average 3-year revenue or the employee count, depending on the industry classification. For example, code 541512 – Computer Systems Design Services specifies a $27.5 million threshold, while code 541711 – Research and Development in Biotechnology stipulates a maximum of 500 employees to be considered small. The survey automatically terminated if a respondent indicated its company was not small.

*New Ethics Requirements of the FAR — Questions 6-8?*

The questions in this grouping focused on the small-business government contractors’ familiarity with the new ethics provisions and their opinion regarding the reasonableness and effectiveness of such requirements. It is important to note there was a reduction in the number of responses beginning with question 6 through the remainder of the survey. This decrease to an average of 70 responses per question was due in part to further filtering of the data through questioning (i.e., excluding businesses other than small) and the likelihood that commercial businesses extracted chose to exit the survey prematurely, as the questions were specific to government contractors and did not pertain to them. (See discussion on filtering commercial business in question 3 above.) The survey tool accounted for respondents removed from the pool by including them in the “skipped” question count.
Question 6, the first in this series, sought to ascertain the company’s familiarity with the rule. The survey showed only 30.1% of respondents really knew and understood the rule, while 69.9% were only somewhat familiar or not familiar at all. The survey sample is not representative; however, the responses aligned well with the stated assumption that many small businesses would not be familiar with the rule.

The implication is that a small business cannot comply unless it is aware of the regulatory changes. Non-compliance poses a risk that could adversely impact
a company’s ability to obtain government contracts. To the small-business government contractor, that would be its demise.

Figure 4.7. Survey question 7: Reasonableness of requirement.

The next question inquired as to the reasonableness of the rule in terms of compliance for small businesses. Roughly 36.1% of respondents believed small businesses should be able to comply with the modified requirement, while 48.6% of respondents thought it was somewhat reasonable to ask businesses to comply. The high percentage indicating the respondents’ confidence in their ability to comply with the modified rule was expected; however, it may be an indicator that these businesses are not familiar with the rule and are not aware of issues
surrounding compliance. Only 15.3% commented that compliance with the rule was not reasonable for small entities. It is conceivable that the dissension is owing to the lack of guidance and clarity regarding compliance, as discussed earlier in the analysis of public comments.

The final question in grouping 2 asked the respondents’ opinion about the expected effectiveness of the rule in reducing unethical business practices. Respondents believing the rule would be somewhat effective or very effective comprised 63.9% of the total. This suggests that these companies consider the rule, or having a code of conduct, as having some degree of value and viability as a
deterrent to ethical misconduct. It stands to reason that these companies would comply with the rule, not only because it is a requirement, but also because they have some level of confidence in its effectiveness.

This is in stark contrast to the opinion of roughly 36.1% of the respondents that had no confidence the rule could curtail business improprieties. Initially, one might deduce that this group of respondents did not believe a code of ethics was a significant or effective instrument in fostering an ethical environment. However, after cross-tabulating their responses with other questions focused on ethic programs and codes of conduct (discussed in detail in subsequent analysis), it became quite obvious that their dissension was centered on the belief that the rule, as written, was insufficient to achieve goals. In other words, curtailing misconduct required a beyond-compliant effort.

One of the assumptions going into the survey study was that small businesses would have little confidence that the rule would be effective. This was based on the government’s unwillingness to provide guidance and its inability to enforce, as discussed in the comments section. However, the majority of responses received actually suggest the rule will have varying levels of effectiveness and those that question the effectiveness do so not because of the impracticality of enforcement, but because of the insufficiency of the requirement as written.
Company’s Existing Ethics Program — Questions 9-11

Grouping 3 comprises a series of questions centered on a company’s existing organizational ethics programs and efforts. The chart below represents the results.

![Histogram showing the results of the survey question on whether a company has an ethics program.]

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>76.4%</td>
<td>55</td>
</tr>
<tr>
<td>No</td>
<td>22.2%</td>
<td>16</td>
</tr>
<tr>
<td>I don’t know</td>
<td>1.4%</td>
<td>1</td>
</tr>
</tbody>
</table>

Figure 4.9. Survey question 9: Company’s ethics program.

Over 76% of the respondents stated their companies had existing ethics programs, while roughly 23% (including the respondent that did not know) had no program. Understanding this was not a representative sample, the researcher did not expect there to be many small businesses with ethics programs due to the associated financial burden. As discussed previously, the FAR Councils released a
Regulatory flexibility Analysis to determine the impact the regulation would have on small business. The report estimated the start-up cost for a formal ethics program and internal control system to be approximately $10,000 plus additional costs for training and ongoing maintenance.

The researcher determined through subsequent analysis provided later in this section, that the percentage of companies with ethics programs was inflated because the survey did not provide a standard definition of an ethics program. Had the inquiry included the definition of the formal program with internal controls as described in the FAR, the result would have certainly been much smaller.

![Survey question 10: Company's code of ethics](image)

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>83.3%</td>
<td>60</td>
</tr>
<tr>
<td>No</td>
<td>15.3%</td>
<td>11</td>
</tr>
<tr>
<td>I don't know</td>
<td>1.4%</td>
<td>1</td>
</tr>
</tbody>
</table>

Figure 4.10. Survey question 10: Company’s code of ethics.
As indicated above, the vast majority of respondents stated that their company had a code of conduct, meaning 83.3% of respondents were already “loosely” compliant with the regulation. This is in line with the FAR Councils’ assumption that “most companies already have some type of ethics code” (U.S. DOD, GSA, and NASA 2007); therefore, the burden to small business would not be excessive. The other 16.7%, however, would have to develop a code for their organization in order to comply. The researcher raises the issue that having a code and promoting it within the organization complies with the letter of the regulation; however, it may or may not advance the spirit of the regulation, which is to promote fair competition. Compliance with both the letter and the spirit of the law requires the company to take measures that are beyond mere compliance.

The third question in the series asked about the frequency of training within the organization. Training may be an indicator of the company’s efforts to
promote ethics within the organization. The results are as follows:

![Survey Question 11: Ethics Training](image)

**Figure 4.11.** Survey question 11: Ethics training.

The survey revealed that 22.2% of respondents conducted one-time ethics training as part of the on-boarding process, while roughly 57% indicated they trained their employees on a recurring basis. Ten respondents (13.9%) chose to
elaborate on their training frequency as listed in the table below.

Table 4.12. Participants’ comments on ethics training frequency

<table>
<thead>
<tr>
<th>Number</th>
<th>Other (please specify frequency)</th>
<th>Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Periodic updates as part of our company planning and visioning and as specific contracts dictate with pertinent staff.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Both new hire and annually</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Annually and during New Hire Orientation</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Semi Annual</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>as required</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>every 3/4 years</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>sporadically</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>We always say &quot;Don't do anything you wouldn't want written about in the news.&quot;</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Managers and Employees are briefed regarding ethical conduct, especially, those performing on Government site.</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Variable - generally when a situation arises</td>
<td></td>
</tr>
</tbody>
</table>

Response numbers 5, 7, and 10 suggest that those companies did not follow a training schedule, but instead trained on an as-needed basis. Comment 8 is curious in that the content does relate to ethics, but one would hope their training effort is more extensive than merely the statement, “Don’t do anything you don’t want written about in the news.”

At this point, it might be beneficial to cross reference the responses in this grouping in hopes that it would shed some light on the complexity of the ethics program established within the companies. There were 55 companies or 76% of respondents that indicated they had an established ethics program within their organization. That number was higher than expected at the initiation of the study because the researcher assumed many small businesses lacked resources to invest in a formal program. The researcher contends, and the cross-tabulation
confirms, that the results are inflated because each respondent had his or her own perception of what constituted an ethics program, since the survey did not provide a standard definition. As such, one can enhance the perspective by cross-referencing the responses within this grouping to determine if the companies’ efforts include a code of ethics and scheduled, recurring training, at a minimum.

The table below details the findings.

Table 4.13. Cross-tab of responses to questions 9, 10 and 11

<table>
<thead>
<tr>
<th>Q9: Does your company have an ethics program?</th>
<th>Q10: Code of Ethics?</th>
<th>Q11: Ethics Training Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, company has ethics program Respondents: 55</td>
<td>Yes 55 No 0</td>
<td>Recurring 37 Static 13 None/NA 5 As-Needed 0</td>
</tr>
<tr>
<td>No, company does not have program Respondents: 17</td>
<td>5 12</td>
<td>0 3 10 4</td>
</tr>
<tr>
<td>Total Respondents: 72</td>
<td>60 12</td>
<td>37 16 15 4</td>
</tr>
</tbody>
</table>

All 55 companies claiming to have an ethics programs also had a code of ethics and conduct. However of those companies, only 37, or 67.3% offered recurring ethics training to their employees; 13, or 23.6% only trained as part of the onboarding process; and 5, or 9% offered no training. Based on the above, only 37, or 51.4% of the companies included both a code of ethics and recurring training in their internal ethics initiatives. It is interesting to note the companies believed they had a viable ethics program, although there were marked deficiencies in the training component. Merely having a program does not ensure its effectiveness. If small businesses were not exempt, such programs would not comply with the FAR ethics awareness program requirements that encompass

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elements such as formal training, assessments, internal controls, reporting hot
lines, associated policies and procedures, and a senior administrator.

*Compliance with the FAR — Questions 12-15*

The four questions within this grouping are focused on compliance with
the FAR rule and the company’s perception of its ability to comply. The
assumptions going into the study that pertains to this series of questions are: 1) Small businesses will believe they are compliant with FAR provisions even if they
find the requirements confusing and absent of guidance; and 2) Small businesses
with existing ethics programs are likely to reduce their efforts to the point of mere
compliance with the rule.

Figure 4.12. Survey question 12: FAR Compliance.

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>90.1%</td>
<td>64</td>
</tr>
<tr>
<td>No</td>
<td>4.2%</td>
<td>3</td>
</tr>
<tr>
<td>I don't know</td>
<td>5.6%</td>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>answered question</td>
<td>71</td>
</tr>
<tr>
<td>skipped question</td>
<td>35</td>
</tr>
</tbody>
</table>
As expected, 90.1% of the respondents indicated they were compliant with the FAR ethics provisions. Only 4.2% admitted they were not compliant, while 5.6% were not certain of their compliance. It is difficult to ascertain whether such a large percentage believed they were compliant or whether they refused to admit otherwise due to the stigma and risk attached to nonconformance.

Question 13, the next in the series, is a follow-up to question 12. It inquired as to the level of effort the company would need to expend to align its effort with the requirements of the new rule. The expectation was that the two sets of responses would corroborate each other; however, there was unexpected divergence, as the results for question 13 demonstrate below.

![Survey Question 13: Effort for Compliance](image)

Figure 4.13. Survey question 13: Degree of effort for compliance.
A total of 29.4% of respondents indicated that varying degrees of effort would be required in order to comply with the FAR rule, although 90.1% stated they were in compliance. There were even three respondents that chose to skip this question. It appears there was some confusion over compliance that echoes industry’s complaints as recorded in the Federal Register as discussed earlier.

A crosstab of questions 12, 13 and 6, which asked if the companies were familiar with the rule, may prove to be insightful. As seen below, six respondents stated they were not at all familiar with the ethics requirements, yet they believed their efforts were compliant with the rule. Further, four of the six determined compliance would take little effort, even though they stated earlier they were already compliant. This hints at the earlier conclusion that government contractors are not willing to admit non-compliance because of its implications.

<table>
<thead>
<tr>
<th>Q6: To what extent are you familiar with these ethics requirements?</th>
<th>Q12: Compliant with FAR Rule?</th>
<th>Q13: Level of Effort to Attain Compliance**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not at all familiar</td>
<td>Yes 6</td>
<td>No 2</td>
</tr>
<tr>
<td>Respondents: 8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Somewhat familiar</td>
<td>36</td>
<td>1</td>
</tr>
<tr>
<td>Respondents: 43</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very familiar</td>
<td>22</td>
<td>0</td>
</tr>
<tr>
<td>Respondents: 22</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Respondents: 73</td>
<td>64</td>
<td>3</td>
</tr>
</tbody>
</table>

* Two respondents that answered question 6 skipped this question.
** Five respondents that answered question 6 skipped this question.

A total of 43 respondents said they were somewhat familiar with the requirements, but 36 of these believed they were in compliance with the FAR’s
ethics provisions. Again, it is difficult to explain the inconsistency except for the explanation stated above, that companies are reluctant to claim incompliance. It is not likely that a company could fully comply with a regulation with which it is not familiar. In the last category, 22 respondents were abreast of the new requirements and, as expected, all of them considered their company's efforts to be compliant. However, two of these respondents stated it would take a great deal of effort to attain compliance. It is possible the respondent misread the questions; otherwise, the inconsistency inexplicable.

The last question in this grouping sought to determine the extent to which a company values a code of ethics as a standard within their organization. The intent is to gauge their acceptance of the rule. If a code is a significant factor in their day-to-day operations, then compliance should be relatively easy. If, on the other hand, they do not value a code, it will be more difficult for them to change the culture to comply. These may be companies that will disregard compliance because they know the risk of being detected is minimal.

Question 14 sought the opinion of respondents regarding the significance
of a code of conduct to their business operations. The results are depicted in the chart below.

![Chart showing the percentage of responses to the question of the importance of a code of business ethics to the organization and its overall operations.]

**Figure 4.14. Survey question 14: Importance of a code of ethics**

Of the 70 companies that responded to this question, 37.1% felt a code of ethics was vital to their business operations. Another 55% stated a code of conduct was important or somewhat important, while roughly 6% believed a code was not a significant factor. Only one respondent was unsure.

It is expected that those with a higher regard for a code of conduct will have a correspondingly high regard for compliance with the new rule, as it emphasizes development and promotion of a code of conduct within the
organization. Cross-tabbing responses of two previous questions that inquired about compliance and having a code, renders results that validate this assumption.

Table 4.15. Crosstab of responses to questions 14, 12 and 10.

<table>
<thead>
<tr>
<th>Q14: How important is a code to your organization and its overall operations?</th>
<th>Q:12 Compliant with FAR Rule?</th>
<th>Q:10 Have Code of Ethics?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not important</td>
<td>Respondents: 4</td>
<td>Yes 3 No 1 Don't Know 2</td>
</tr>
<tr>
<td>Somewhat important</td>
<td>Respondents: 20</td>
<td>17 1 2</td>
</tr>
<tr>
<td>Important</td>
<td>Respondents: 19</td>
<td>18 1 1</td>
</tr>
<tr>
<td>Extremely important</td>
<td>Respondents: 26</td>
<td>23 1 1</td>
</tr>
<tr>
<td>Not sure</td>
<td>Respondents: 1</td>
<td>1</td>
</tr>
<tr>
<td>Total Respondents: 70</td>
<td>62 3 4</td>
<td>59 11 0</td>
</tr>
</tbody>
</table>

* One respondent that answered question 14 skipped this question.

Of the 45 respondents that believed the code of conduct was either important or extremely important to its company operations, 91.1% (41 respondents) stated their company had a code of ethics and was compliant with the FAR rule. As for the 20 respondents that indicated a code of ethics was somewhat important, 85% believed they were compliant, but only 80% stated their company had a code of conduct. Three of the four respondents that felt a code was unimportant also stated that their company was compliant with the rule, while only two of the four stated that their company had a code of conduct. It is noteworthy that companies without a simple code of conduct believed they
were compliant with the ethics requirements mandating development of a code and promoting compliance within the organization. Again, it is impossible to ascertain whether these companies are in denial, unwilling to admit non-compliance, or whether they sincerely do not understand how to comply. One of the assumptions the researcher derived during the initial phase of the survey was that many small businesses would be concerned about their ability to comply.

Question 15, the last question in the series, asked if changes in the government’s policy on ethics would directly influence the company’s existing efforts in organizational ethics, particularly for those companies that had an established program. The underlying concern was the possibility that changes in the ethics requirements of the FAR could cause an overjustification effect wherein the company would lose its pre-existing intrinsic motivation to establish an ethical business environment, because the extrinsic value of compliance would become the priority. This is particularly problematic because a company with a “true” ethics program would typically have in place requirements that exceed those of the FAR rule. However, if less is sufficient for compliance, the small business might be inclined to reallocate resources from the ethics program to another area of the business. One of the researcher’s assumptions going into the study was that small businesses would decrease the investment in their ethics
program and use the resources to satisfy other priorities. The results of question 15 are depicted in the chart below.

As shown, 67.1% of respondents stated they would not diminish their existing efforts and reallocate the investment, while only 7.1% combined would likely or very likely consider such action. The results, which differed from what was expected, indicated that the majority of respondents valued their beyond-compliant efforts and intended to invest in that area. However, the inclination of some respondents to strategically reduce their investment could be the result of an overjustification effect, where their intrinsic motivation is compromised.
Roughly 25.7% or 18 respondents felt the question was not applicable, presumably because they did not have a mature program. The response total is consistent with similar questions posed earlier in the survey.

*Opinion of Government’s Policy Change — Questions 16-21*

The final series of questions focused on the respondents’ opinion of Government policy changes, particularly as it pertained to federal acquisitions. Specifically, the questions sought to reveal the respondents’ perception of the effect an evolving federal acquisition environment might have on their current and future business activities.

![Survey question 16: Effect of rule on company's business](image)

Figure 4.16. Survey question 16: Effect of rule on company’s business
The first question of the series inquired whether the new FAR rule caused any immediate impact on their business operation. The purpose of this question was to provoke thought and encourage the respondent to take an introspective look at how the rule may potentially affect their business. The question asked respondents to post brief comments about the topic at hand. Nearly 99% of respondents stated the rule had not noticeably affected their company, which would be expected because the rule is not retroactive and would only apply to companies with a new contract award in excess of $5 million. Further, as previously discussed, some companies were not at all cognizant of the change in regulation; therefore, they would not be aware of any impact.

The results ensuing from this question that are of greater interest are the 16 comments the respondents shared about their opinion of or experience with the new regulation. The essence of the comments fall within four broad categories: 1) overregulation complaint 2) unawareness or misunderstanding of the rule; 3) attempt to do the “right thing”; and 4) no impact.

There are five comments that express discontentment with the perceived increased regulation associated with the new rule. The main emphasis is on the futility of the regulation or the financial burden it imposes on small business, as detailed below.
Table 4.16. Respondents’ comments regarding overregulation

<table>
<thead>
<tr>
<th>Response Number</th>
<th>Overregulation Complaint (Direct quotes from respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>We are a small business and are grateful that the government is not imposing another DOCUMENTED program on top of all of the other administrative burden we have.</td>
</tr>
<tr>
<td>11</td>
<td>This just adds one more level of paperwork / certification to all contracts / subcontracts.</td>
</tr>
<tr>
<td>16</td>
<td>Many small businesses to not have a ethics policy to the extent of the FAR, this can be a costly function to push forward on the small business person, but a necessary evil.</td>
</tr>
<tr>
<td>4</td>
<td>The Governments method of preventing anything is to create another rule or regulation, which really doesn’t do much. Irrespective of how many internal policies an organization has, none of those policies can prevent someone from doing something unethically. It is often felt, that the Government creates additional requirements to ensure that if something does go wrong, that the Government can say; ‘gotcha’. Any good company in the US always endeavors to conduct business in a fair and ethical way. However, policing individuals is an impossible and futile effort. If a person is dishonest, then in matters not what any policy or procedure may state. A dishonest individual will remain dishonest, until caught.</td>
</tr>
<tr>
<td>7</td>
<td>Government oversight as an entire entity is overwhelming small business. Just to complete a recent Affirmative Action Program has taken our controller 125 hours to complete and now revisions are being asked for because of new requirements. Not everything can be regulated, if a business performs &quot;good business&quot; then they should be awarded more contracts but when everything is low bid and high ethics are demanded then it becomes a problem. To under bid means something has to be cut, either quality or ethics or both.</td>
</tr>
</tbody>
</table>

The first two comments clearly express complaint about the increased administrative burden regulation places on small business. When a company has to assign additional staff or additional hours to existing staff to complete regulatory paperwork, there is a corresponding increase in labor cost. The size of the small business and the extent of its capitalization greatly influence the degree of sensitivity that business has with regards to cost. The first comment is sarcastic
and reveals the respondent’s frustration with existing regulatory tasks considered excessive and unnecessary.

The respondent posting the third comment attaches a high price tag to compliance with the FAR rule, and complains that it is unfair to levy such expense on a small business. It is the respondent’s perception that the lack of an ethics policy is endemic in the small business community; yet, he or she acquiesces in its necessity. This comment suggests that small businesses may be concerned about their ability to attain compliance due to inadequate resources.

The fourth comment regarding increased regulation touches on several different areas to include frustration with ineffective policy, the futility of the ethics requirements, and the resulting strain in industry-government relations. First, the respondent criticizes the government for using regulation as its method of choice for control despite its ineffectiveness in bringing about desired results. This, the comment suggest, is particularly true for the ethics requirements, which are inadequate to modify a dishonest person’s behavior. In fact, the respondent concludes the only thing that stops a dishonest person is that person being caught. What is of interest is the fact that the rule without exceptions for small business, mandated a full ethics awareness program with evidence the organization was promoting an ethical culture and prompt disclosure of criminal activity. The follow-on rule also called for the implementation of internal control
systems to detect business improprieties, which would ultimately help catch the dishonest employee. Perhaps one could conclude that the respondent is advocating that anything short of a full program with systems and internal controls to detect unethical activity is futile. Policies alone cannot prevent unethical behavior. In other words, the respondent’s frustration may be that an effective approach is too costly for small business, so why should the government saddle small business with methods that are ineffective.

Further, the fourth comment accuses the government of implementing policy rooted in distrust toward the contractor. The primary goal, then being for the government to be able to say, “gotcha” should the contractor err. This general mentality, which hints at strained contractor-government relations, is reminiscent of the government contracting environment during the infancy of the FAR in the early 1980’s, as discussed in Chapter 2. During this time, the volume of regulation became so great and restrictive that it produced more of an adversarial relationship rather than a cooperative partnership between the government and contractor. The contract had become a “contract of adhesion,” reflecting a power relationship, not a consensual agreement” (Nagel 2012, 153). As a result, industry shied away from conducting federal business. The respondent suggests that a similar atmosphere exists today.
The final comment on this subject is a loaded one. First, the respondent shares an opinion on how government regulation is overwhelming small business. Again, there is the frustration in having to allocate resources to satisfy the requirements of government regulation, in this case the respondent referred to creating an Affirmative Action Program. Apparently, the respondent is relating that experience to the effort he or she believes will be necessary to satisfy the FAR requirements. The obvious message is that regulation is already too much for small business.

The second part of the comment uncovers what the respondent sees as an inconsistency in acquisition policy – government demanding high ethical standards, which can be costly, but at the same time initiating efforts to cut government costs by squeezing contractors' profit margins. The comment refers to the trend in government contracting over the past few years to use Lowest Price Technically Acceptable (LPTA) as the basis for contract award. Provided the technical bid was acceptable, the contractor with the lowest price would win the contract, whether it represented the best value to the government or not. This environment created a collective action problem where contractors engaged in a race to the bottom by continuing to cut their prices to win the work at the expense of being able to perform. An article in *Washington Technology* states that LPTA "seems like the perfect approach to procurement if you ignore for a moment that
it puts bidders in a death spiral, stripping away every performance advantage as they race to the bottom to be the lowest priced offeror” (Lohfeld 2015). The respondent takes issue with the government engaging in this activity while demanding that his or her company invest more in ethics compliance. This might suggest the respondent was questioning the government’s sincerity.

The next category comprises five comments that pertain to the respondent’s unawareness or misunderstanding of the rule, as illustrated below.

<table>
<thead>
<tr>
<th>Response Number</th>
<th>Unawareness or Misunderstanding of the Rule (Direct quotes from respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>We provide staff augmentation services under either a contract award basis as a subcontractor, or through the GSA Schedule 70 under specific purchase orders</td>
</tr>
<tr>
<td>10</td>
<td>Most small businesses (more specifically my company) are not impacted by the FAR clause 52.203-13 because we do not have non-commercial contracts in excess of $5,000,000. Since we do not have a contract in excess of $5M, this FAR clause does not pertain to us.</td>
</tr>
<tr>
<td>6</td>
<td>We were not aware of the ethics changes of the FAR</td>
</tr>
<tr>
<td>8</td>
<td>I was not aware of such changes.</td>
</tr>
<tr>
<td>12</td>
<td>Most small businesses have been reasonably in compliance for a long time. We have always followed the basic rules. We are a subcontractor for Lockheed and therefore were required to formalize a program years ago. The government somehow believes that all Government contractors are crooks but we really aren't.</td>
</tr>
</tbody>
</table>

The respondent makes the case that the rule does not pertain to their company because they only provide staffing to a government prime contractor or through a General Services Administration (GSA) schedule purchase order. However, the respondent does not fully understand that it is the dollar amount
and period of performance that determines whether or not the rule pertains to subcontractors. For example, if a small business prime contractor receives a multi-year award with a total value of $15 million and the prime elects to subcontract out $5 million or more to another small business, then that subcontractor is subject to the same ethics requirements as the prime. The clause would flow down to any subcontract that meets the period and dollar volume criteria. If, by chance, the subcontractor were a large business, the subcontractor would be subject to all provisions under the ethics clause; the small business prime’s exemptions would not flow down. Therefore, unknowingly the respondent could be subject to FAR Clause 52.203-13e through its subcontract or GSA purchase order. In such case, the company would be non-compliant with FAR dictates.

The second comment indicates that the respondent business is not subject to the FAR clause because its government contracts do not exceed the dollar threshold. This comment suggests that the respondent, who is well aware of the rule, has decided not to take a proactive approach by initiating efforts towards compliance in anticipation of receiving a prime or subcontract award in excess of $5 million. Often small businesses are not in position to expend resources unless there is an immediate return.
In both the third and fourth comments the respondents stated they were unaware of the changes to the FAR; as such, they would not be able to detect any impact to their business. Going into the study, the researcher assumed many small businesses would not be aware of the ethics requirements due to the lack of resources to track issues and changes in government policy. This puts small business at risk of non-compliance with the FAR—a position government contractors strive to avoid because of obvious implications.

The final comment indicates that the respondent has a formal ethics program; therefore the company is compliant. However, the very first statement is of interest because the respondent assumes the majority of small businesses are “reasonably in compliance.” It is doubtful that the government recognizes degrees of compliance. Either one follows the rules and is compliant or one is not. The notion that a business can pick or choose which rules to observe or it can simply do its best and that’s sufficient is incongruent with compliance. This is a snare into which small businesses often fall because it is the path of least resistance. Again, it places the business at risk.

In the next category of comments the respondents sought to convey the extent to which they attempt to do the “right thing” even if they are not fully in compliance with the FAR. The three comments in this grouping are as follows:
Table 4.18. Respondents’ comments regarding their effort to comply

<table>
<thead>
<tr>
<th>Response Number</th>
<th>Attempt to do the “right thing” (Direct quotes from respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>We do not have a formal ethics program. However we train our employees to comply with Government ethics and internal guidelines.</td>
</tr>
<tr>
<td>5</td>
<td>I do all government business and try to meet all requirements so we have no problems and to the best of my ability ensure all of what we do is correct.</td>
</tr>
<tr>
<td>9</td>
<td>The vast majority of Un-Ethical behavior in the Government Contracting World is initiated by Government Employees. We turn our back on those people and walk away from those &quot;Opportunities.&quot;</td>
</tr>
</tbody>
</table>

In the first two comments it is quite clear that the respondents believe they are diligent in their efforts to do what is right. However, there are undertones that suggest the respondents understand there is a business risk associated with non-compliance, yet there is uncertainty around their ability to comply. In the first comment, the respondent indicates they train their employees to comply with Government ethics and internal guidelines, but the statement is ambiguous. Compliance with Government ethics within the context of government contracting typically refers to restraint from engaging in criminal activity associated with the acquisition process (e.g., offering bribes, kickbacks, acquiring source-selection sensitive materials). Compliance in the study is specific to FAR clause 52.203-13, Contractor Code of Business Ethics and Conduct. While training in the area of criminal activity is critical, this alone does not fulfill the requirements of the FAR clause. Comment two states that the respondent tries to comply to avoid problems and does everything to the best of his or her ability to do what is right. In both comments, the respondents show the companies are diligent in their
efforts to follow and instill ethical business practices into the organization, but neither appears certain they comply with FAR. A company can only attain compliance by being aware and understanding the changes to regulation.

The third comment raises the issue of unscrupulous civil servants who attempt to sell opportunities to contractors. The respondent's message is that the ethics requirements are misdirected because it is not the contractors, but the government employees that initiate the majority of unethical practices in the federal contracting arena. The respondent indicates his or her company chooses to do the “right thing” and resists those offers.

The final three comments indicate that the rule has had no impact whatsoever on their business. It appears these companies were aware of the changes and proactive in their efforts to maintain compliance. The comments are as follows:

Table 4.19. Respondents not impacted by the rule

<table>
<thead>
<tr>
<th>Response Number</th>
<th>No Impact (Direct quotes from respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Our ethics program is a mature program and fully vetted. The recent changes did not create any impact to our program or our business operations.</td>
</tr>
<tr>
<td>14</td>
<td>Our company was already in compliance and working on areas that were soft.</td>
</tr>
<tr>
<td>15</td>
<td>We’ve seen no affect whatsoever.</td>
</tr>
</tbody>
</table>
The first two respondents implied that there was no impact because they already had pre-existing ethics programs within their organization. In fact, one respondent stated that the company had already begun to engage in process improvement activities for their program. Clearly these companies had already committed to going beyond compliance since the establishment of a mature ethics program was never a requirement for small business. The final respondent specified there was no impact to the company. The researcher is making the assumption the company was already compliant; therefore there was no effect on the organization.

Question 16 invited the respondents to discuss in brief the effect of changes to the ethics requirements of the FAR on their business. A total of 16 of the 69 respondents took advantage of the opportunity and voiced a wide range of issues regarding FAR Clause 52.203-13. They complained about the impact of overregulation on small business and the ineffectiveness or futility of the requirements; they expressed concern about their ability to comply, although they felt they were diligent in trying to do the “right thing”. There were those who were unaware of the changes or misunderstood the requirements. Finally, there was the perception that the rule was misguided and needed to address the primary culprit in contracting misconduct—the civil servant. The analysis reveals
there are valid concerns in the small business government contracting community regarding the implementation of and compliance with FAR Clause 52.203-13.

Question 17 inquired about whether the government acted within its authority when it mandated that small-business government contractors have a code of conduct. Participants were asked the extent to which they believed the government crossed its boundaries. The graph and table below depict the results.

Approximately 47.8% felt the government acted within its authority and took no exception with the mandate. Nearly 30% agreed somewhat, roughly 18%
agreed or strongly agreed. Only 4.4% indicated they did not know. The researcher, going into the study, expected most small businesses would not consider the government’s actions as stepping over the line primarily because small businesses were exempt from the more stringent requirements of FAR Clause 52.203-13. The results align with the assumption since 47.8% disagreed and another 30% agreed, but only somewhat.

Question 18 inquired about the respondents’ perception of the government’s sincerity in its effort to raise the ethics standard for government contractors. Participants were asked to express the extent to which they agreed the efforts were sincere. The chart below details the findings.
Approximately 18% of the respondents disagreed with the statement and thus questioned the government's sincerity, while 46% agreed or strongly agreed the government was genuine in its efforts to “reel in” contractors. Another 31% agreed with the statement, but with reservations. Only 5% expressed no opinion by stating they did not know.

It is clear that among the respondents, the vast majority believe the government is resolute in its agenda to raise the ethics standard for contractors. As such, it is easy to understand why many of the responses and comments reflect some level of anxiety surrounding the companies’ ability to understand,
implement and comply with FAR clause 52.203-13. Those that agreed somewhat obviously had concern about the extent of the federal government’s sincerity. This could suggest that these companies might be willing to take more risk regarding compliance believing the likelihood of their getting caught would be minimal.

At this point it is beneficial to cross tabulate the responses for question 18 with responses to question 8 that inquired about the effectiveness of the rule in curbing misconduct.

Table 4.20. Crosstab of responses to questions 18 and 8

| Q18: The government is obviously sincere in its efforts to crack down on fraud and raise the ethics bar for government contractors. | Q:8 How effective do you believe these measures will be in curtailing business misconduct? |
|---|---|---|---|
| Disagree | Respondents: 12 | Not Effective | 10 | Somewhat Effective | 2 | Don't Know | 0 |
| Agree somewhat | Respondents: 21 | 6 | 15 | 0 |
| Agree | Respondents: 25 | 8 | 14 | 3 |
| Strongly Agree | Respondents: 6 | 0 | 3 | 3 |
| Don’t Know | Respondents: 3 | 2 | 1 | 0 |
| Total Respondents: 67 | | 26 | 35 | 6 |

It is noteworthy that of the 18% (12 respondents) that believed the government was only paying lip service to the idea of raising the ethics standards, 10 concluded that the ethics requirements would not be effective in preventing unethical business practices, while the other 2 felt the rule could be somewhat effective. This could suggest that respondents questioned the sincerity of the
effort based on the ensuing ethics requirements and their perceived lack of efficacy. This tracks with earlier findings that demonstrated many respondents believed a code of ethics alone was an ineffective tool.

The majority (71%) of those that agreed somewhat that the government was sincere thought the new requirements would be somewhat effective, while 29% thought they would not be effective at all. Of the 31 that either agreed or strongly agreed, 17 believed the ethics requirements would be somewhat effective, while 8 thought they would not be effective. This finding is significant because it indicates that many respondents believe the government is sincere in its efforts, but the methods selected to advance its agenda are not effective. The researcher expected that small businesses would have little confidence in the effectiveness of the provisions of the rule relevant to small business contractors. This statement resonates throughout the study.

Question 19 addresses the respondents’ opinion of the reasonableness of the government’s mandate to have a code of business ethics and conduct. This question relates very closely to question 17 that solicited the respondents’ view on whether the government was overstepping its bounds.
The graphic above shows that 26 of the 67 respondents (38%) agreed or strongly agreed that the requirements were not unreasonable, while 27 respondents (40.3%) agreed somewhat that the requirements were not unreasonable. These findings align with the researcher's assumption that the majority of small businesses would conclude that the provisions of the rule were reasonable as a condition of doing business. Of the remaining respondents, 13
disagreed and found the requirements to be unreasonable, and 1 respondent expressed no opinion by selecting the “don’t know” response.

Question 20 inquired as to whether the FAR Clause provided sufficient guidance on how to comply with the requirements. The results were rather alarming as shown below.

![Graph showing survey results for Question 20](image)

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>Response Percent</th>
<th>Response Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>31.3%</td>
<td>21</td>
</tr>
<tr>
<td>No</td>
<td>26.9%</td>
<td>18</td>
</tr>
<tr>
<td>Unsure</td>
<td>41.8%</td>
<td>28</td>
</tr>
<tr>
<td>answered question</td>
<td></td>
<td>67</td>
</tr>
<tr>
<td>skipped question</td>
<td></td>
<td>39</td>
</tr>
</tbody>
</table>

Figure 4.20. Survey question 20: Clarity of new ethics requirements.

Only 31% of respondents indicated that the clause provided clear guidance, while 69% of respondents were uncertain or stated guidance was lacking. This means the vast majority of respondents did not understand how to comply with the new rule, which puts them at risk of being incompliant. It is very
likely that some respondents had never seen FAR Clause 52.203-13 prior to taking the survey. This is typical of small businesses because they often lack resources to stay abreast of policy changes or to engage legal professionals to interpret legislation and propose implementation to ensure compliance.

Comparing responses to this question with those of question 12 (compliance with the rule) yields findings that are problematic.

Table 4.21. Cross-tab of responses to questions 20 and 12.

| Q20: Do you believe the new clause as detailed in Section 2 provides clear guidance on how to comply with the new requirement? | Q12: Compliant with FAR Rule?* |
|---|---|---|
| Yes | Respondents: 21 | Yes No Don't Know |
|    |    | 20 | 1 | 0 |
| No  | Respondents: 18 | 16 | 2 | 0 |
| Unsure | Respondents: 28 | 23 | 0 | 4 |
| Total Respondents: 67 | 59 | 3 | 4 |

* One respondent that answered question 20 skipped this question.

As stated above, roughly 69% or 46 respondents were unsure or felt the clause lacked sufficient guidance; however, 39 of these same respondents indicated they were compliant with the FAR rule. There is obviously a major inconsistency here, as a company cannot regularly comply with rules of which it is not aware or it does not understand. In this case, perhaps the contractors inadvertently defined compliance as a concerted effort to do the “right thing”
when handling the affairs of their business. (Certainly this line of thinking was pervasive in the previous discussion of question 16.) Even so, this highlights how a company can capriciously dismiss compliance in hopes that whatever they are doing is sufficient to keep them out of trouble. The findings align with the researcher’s assumption that small businesses would believe they were compliant with the FAR Clause even if they found the requirements confusing and absent of guidance. This places the small business at risk.

Question 21, the final inquiry, explored the possible effect increased regulation could have on a small-business government contractor’s willingness to conduct business with the federal government. Specifically, the researcher was curious to see if there was a possible recurrence of a phenomenon that occurred in the early 1970’s, when companies tended to shy away from federal business in the wake of the promulgation of myriad regulations aimed at ensuring fair competition in the government acquisition process (as discussed earlier in Chapter 2). The trend in increased regulation actually served as a disincentive to seek contracts in the federal arena. The results of the inquiry are presented below.
Of the 67 respondents, 43 (64.2%) indicated regulation had no impact on their desire to perform government contracts, while 18 (26.9%) stated it had some effect, and only 6 (9%) said it greatly affected their desire to conduct business in the public sector. The results are not surprising. Going into the study, the researcher assumed increased regulation would have minimal impact on small-business government contractors’ willingness to continue to service the government client, based on several factors. First, the small business contractor typically lacks the flexibility or desire to forego any line of business provided it is at all profitable. Second, changing a company’s primary focus from federal to
commercial would require a complete transformation of its current business model, which would be a costly proposition. At a minimum this would entail retooling—retraining or replacing current staff with professionals having commercial experience—revising strategic, marketing, and business development plans, and researching and studying the commercial market to learn how to operate therein. Third, it is often difficult for small businesses to break into the commercial sector; however, the federal government is a huge market that encourages small business participation through diverse set-aside programs. A company can thrive as a small-business government contractor, provided the company takes the necessary measures to comply with federal regulations.
Research Study: Focus Group Results

The researcher conducted a focus group with four executives representing three small-business government contractors. The researcher abandoned the plan to have three separate focus groups because of the inability to obtain commitment from a sufficient number of small business executives. The one focus group that participated provided rich and insightful discussion on the topic based on years of experience in government contracting.

In analyzing the data, the researcher organized the responses in the same groupings used to analyze the survey data, with the exception of grouping 1, which was not used in the focus group. The tables outlining the focus group question and responses also provide the corresponding survey question number for reference purposes. The focus group questions were multi-part, meaning one question may have several corresponding survey questions. Arranging the results in this fashion facilitated analysis and comparison of data from both the focus group and survey. The four groupings (commencing with grouping 2) are as follows:

2. New Ethics Requirements of the FAR — Questions 2A, 3A
3. Company’s Existing Ethics Program — Questions 4A
4. Compliance with the FAR — Questions 3B, 4B, 5
New Ethics Requirements of the FAR - Focus Group Questions 2A and 3A

There are two questions in this grouping that focus on the small-business government contractors’ opinion regarding the reasonableness and effectiveness of the new ethics provisions of the FAR. Each question references a corresponding survey question to facilitate analysis and comparison of results.

Focus Group Question 2A: To what degree do you believe these ethics requirements of the FAR are reasonable for a small business in terms of compliance? (Maps to Survey Question 7)

Table 4.22. Responses to Focus Group Question 2A

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Reasonableness of Requirements (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 3</td>
<td>The FAR is very long and arduous, but I think the part that deals with ethics basically just says you’re going to be honest, you’re going to be upright, and you’re not going to cheat the government. And you’re going to practice good business processes and procedures. So I think it’s reasonable in that sense. Because it doesn’t put a whole lot of extra burden on you to be forthright upright and honest in your business dealings. So, I think it’s reasonable.</td>
</tr>
<tr>
<td>Company 1</td>
<td>So I think anybody that’s doing any level of work need to have these ethics requirements implemented. So it should be a part of every organization regardless of the size.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>I generally agree with the basic premise where you have to abide by certain rules and regulations and have ethics. But, you have to keep up. How to keep updated with all the regulations out there? For a small company with limited resources it’s a challenge. Generally speaking I think it’s reasonable.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>Reasonable but for a very tiny company it’s a challenge because you got to have a whole HR department to put together the training every year</td>
</tr>
</tbody>
</table>
Initially it appears that all four respondents, representing three small businesses, agree that the requirements are reasonable and compliance is attainable. In fact, the first two respondents applaud the effort and believe the tenets should be a basic standard for any company doing business. This suggests confidence in their understanding and ability to comply. The other two respondents, representing the same small business, expressed the reasonableness of the requirements, but both voiced objections due to the challenge of remaining abreast of regulations and the drain on resources for maintaining compliance. They highlight their concern about the difficulty of sustained compliance.

The focus group responses align with the responses to the corresponding survey question (number seven,) where the majority of companies believed compliance with the rule was reasonable for small businesses. An assumption entering the study was that small businesses were concerned about their ability to comply; however, the survey and focus group suggest those that are insecure about compliance may constitute only a minority of small businesses contractors.
Focus Group Question 3A: How effective do you believe these measures will be in curtailing business misconduct? (Maps to Survey Question 8)

Table 4.23. Responses to Focus Group Question 3A

<table>
<thead>
<tr>
<th>Participant’s Identifier</th>
<th>Effectiveness of Requirements (Direct Quotes from Participants)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 1</td>
<td>I think it’s a step in the right direction. Any degree of prevention is a good thing. We might not be able to get it 100%, but any degree in the direction of 100% is a good thing. So it will help minimize or reduce [business misconduct].</td>
</tr>
<tr>
<td>Company 3</td>
<td>Company 3 concurs with company 1. (It's a step in the right direction.)</td>
</tr>
<tr>
<td>Company 2B</td>
<td>It’s necessary and good to have.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>It’s essential to have a code of ethics.</td>
</tr>
</tbody>
</table>

Question 3A asks the participants to share their view on the expected effectiveness of the rule in reducing unethical business practices. All four companies concur that a code of conduct has some degree of value and viability as a deterrent to ethical misconduct. As such, one can expect these companies to be willing to comply with the rule, not only because it is a requirement, but also because they have some level of confidence in its effectiveness. Companies 1 and 3 acknowledge the requirement will render some degree of effectiveness, but they clearly articulate that the requirement for a code alone is insufficient as a solution to eradicate business misconduct. That is, curtailing such practices requires a beyond-compliant effort.
One assumption going into the study was that small businesses would have little confidence in the effectiveness of the rule. As previously discussed, this was based on the government’s unwillingness to provide guidance and its inability to enforce. Responses from both the focus group and survey suggest the rule will have varying levels of effectiveness. Where the requirement falls short in its efficacy is not because of the impracticality of enforcement, but because of the insufficiency of the requirement as written.

*Company’s Existing Ethics Program - Focus Group Question 4A*

Questions in this grouping inquire about the types of ethics-awareness activities in which the companies currently engage. The single focus group question aligns with three survey questions addressing this topic.

**Focus Group Question 4A:** Explain your ethics program or efforts including existence of a code of ethics. (Maps to Survey Questions 9, 10 and 11)

<table>
<thead>
<tr>
<th>Respondent ‘s Identifier</th>
<th>Company Ethics Efforts (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 2B</td>
<td>Currently we have our employee handbook [that addresses ethics issues]. We probably want to revisit it and make a PowerPoint slide [presentation].</td>
</tr>
<tr>
<td>Company 2A</td>
<td>Power Point Slides, but we don’t have a hotline.</td>
</tr>
<tr>
<td>Company 3</td>
<td>[We have] good business practices. This [new rule] just came out, but this whole idea of business ethics and Code of Conduct has been around for a long time for large businesses. I remember when I first started working for Unisys, way back when; we worked day in and day out [on code of ethics]. All the managers had to swear to it; we published it; we probably spent a million dollars just publishing nice</td>
</tr>
<tr>
<td>Respondent’s Identifier</td>
<td>Company Ethics Efforts (Direct Quotes from Respondents)</td>
</tr>
<tr>
<td>-------------------------</td>
<td>----------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>brochures that talked about business ethics. But that was probably the extent of it because they got caught up (just like the other large businesses) in ethics violations – cheating on time sheets and those kinds of things. So, it's good to have all of that, but I think just good business practices are what get you through.</td>
</tr>
<tr>
<td></td>
<td>We have a slide presentation on security annual training and we take all those annual training slides and put them on our portal (ADP) and once a year we have all the employees send in, print out right there from the portal, that they reviewed the annual training requirements for security, so you can do the same thing for ethics. I think that's something we can put on our ADP [Employee] website that we were required to have a code of ethics and we want our employees to review it on an annual basis and send us the sheet that they sign [certifying] that they have reviewed [it] on an annual basis. Different level of training for managers because they can do things employees can't do.</td>
</tr>
<tr>
<td>Company 1</td>
<td>Conduct [ethics training] one time and make everything else refresher training by sending out the document to them [the employees] and having them sign it. It can be as simple as that. As long as the information is in front of them.</td>
</tr>
<tr>
<td></td>
<td>Every year we have to have the handbook signed by the employees; we have to have the substance abuse signed by the employees; we have to have a sexual harassment form signed; we have to have the security form signed; the security briefing, debriefing. So there're so many areas.</td>
</tr>
</tbody>
</table>

All participants confirm they conduct some type of ethics effort within their companies. What is of special note is the wide range of responses from the small group. Company 2B indicates they address ethics issues in their employee handbook, but they are considering changing the medium to a Web presentation.
Company 3 has a policy to conduct good business practices (no mention of a documented code of conduct, but one can infer the existence of internal policies) and include security as a component of their ethics program. They conduct recurring security training and intend to incorporate the code of ethics as well. Company 1 conducts ethics training on an annual basis and also includes employee relations and security as part of the ethics effort.

It is problematic that the scope of the ethics effort in the individual companies is so wide that establishing a code to address all aspects could be challenging if not impractical. One cannot deny there are ethics issues associated with employee relations and security clearances, for example. However, the new rule is procurement-focused and would have little bearing, if any, on these type activities. As discussed later, the small business contractor wants more guidance from the government so they can better focus on the specifics and be more strategic in their compliance efforts.

_Compliance with the FAR - Focus Group Questions 3B, 4B and 5_

The three focus-group questions constituting this grouping address compliance with the FAR rule and the company’s perception of its ability to comply. Each question corresponds with a survey questions within the same grouping. The assumptions related to these focus-group questions are: 1) Small businesses will believe they are compliant with FAR provisions even if they find
the requirements confusing and absent of guidance; and 2) Small businesses with existing ethics programs are likely to reduce their efforts to the point of mere compliance with the rule.

**Focus Group Question 3B: How important is a code of business ethics?** (Maps to Survey Question 14)

Table 4.25. Responses to Focus Group Question 3B

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Importance of a Code of Business Ethics (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 3</td>
<td>Yes, a code of ethics is important. Code of ethics gives you something to refer back to.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>Generally speaking, it’s good to have and can be enforced in the employee handbook.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>It's essential to have a code of ethics, but then, you have to hire somebody to write your code for you.</td>
</tr>
<tr>
<td>Company 1</td>
<td>It’s very necessary because you want that employee to thinks twice oh, I signed something, oh sexual harassment means this, oh substance abuse could mean this, oh, if I take a gift from a customer it can mean that, if I harass another employees it could mean that. So ... making sure those topics are covered protects the company (and) protects the agency from any type of repercussion that you can have with an employee.</td>
</tr>
</tbody>
</table>

As seen earlier, all four participants indicate the code of conduct is a significant document for reference and for directing internal practices. Company 1 suggests the code can also serve as a heuristic to remind the employee of his or
her commitment to honesty. Having an employee read and sign the code of conduct on a regular basis can be effective in curtailing misconduct.

This line of thinking supports Dan Ariely's theory on dishonesty as discussed earlier. He contends that one can remediate dishonesty through moral suasion, that is, appeal to a code of conduct, code of honor, pledges, commitments, and the like. His studies revealed that subjects were less likely to be dishonest when reminded of their commitment to honesty. (See Chapter 3 for full discussion.)

The participants’ high regard for a code of ethics aligns with the survey findings for question 14, where nearly 94% of the respondents believed a code was an important factor. While the focus group participants perceived value in a code of conduct, none of the companies indicated they had a documented code of conduct in a consolidated format. In most cases, the components were part of other internal policies or documents; compliance is questionable.

Company 2A stated that the code is essential but the company does not know how to comply, as they do not know how to write a code. One of the assumptions the researcher derived was that many small businesses would be concerned about their ability to comply. Company 2A clearly supports this claim.
Focus Group Question 4B: Do you believe your efforts are compliant? Why or Why not? (Maps to Survey Question 12)

Table 4.26. Responses to Focus Group Question 4B

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Compliant Efforts (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 1</td>
<td>Like… what this code requires… we’re compliant with it now, but it’s in different areas. It’s not all in one code of ethics. And ours is based on having an ISO certification for which there is surveillance every year. So, every year we have to have the handbook signed by the employees; we have to have the substance abuse signed by the employees; we have to have a sexual harassment form signed; we have to have the security form signed; the security briefing, debriefing. So there’re so many areas.</td>
</tr>
<tr>
<td>Company 3</td>
<td>I believe that if you follow the …when you sign a contract with the federal government you’re already bound by certain procedures. And just by being in compliance with your contract it’s going to automatically make you compliant with some of the ethics provisions.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>I’m sure there are resources out there, but I’m not sure there are any guidelines as far as what should the code of ethics look like? Are there any guidelines? What if you have it wrong and you’re passing these [policies] out to your employees?</td>
</tr>
<tr>
<td>Company 2B</td>
<td>No comment</td>
</tr>
</tbody>
</table>

Company 1 is confident that its efforts are compliant because it has established policies that it believes encompass everything that is required of a code of ethics. Admittedly so, the company does not have the consolidated code of conduct document that the rule mandates; however, it contends its compliance is based on the existence of equivalent content within the organization. Likewise, Company 3 believes compliance with contractual requirements translates into
compliance with most of the ethics provisions. It has established policies that address some ethics topics, but again, there is no documented code of conduct. It is problematic that both companies lack the requisite document, but still claim compliance with the FAR ethics provisions. Question 12 of the survey rendered similar results where a high percentage of respondents claimed compliance; however, subsequent analysis of related responses showed that some were not familiar with the requirements or claimed that additional efforts were necessary to comply. A possible explanation for this inconsistency that appeared in the survey as well as the focus group response is that government contractors are reluctant to admit incompliance because of its implications. Nonconformance with certain FAR provisions could carry a stiff penalty, including suspension or debarment, which would be the demise of a small-business government contractor.

Company 2A indicated in the previous question that its employee handbook addressed ethics requirements. Obviously there is concern as to whether that effort is sufficient for compliance because the company expressed concern about not knowing what should be covered in a compliant code of ethics. The company did not admit incompliance, but one may infer such based on the response.
**Focus Group Question 5:** If your company already has a mature ethics program that exceeds FAR requirements, how likely is it that you would scale back your program to the point of mere compliance in order to reallocate valuable resources? Please Explain. (Maps to Survey Question 15)

<table>
<thead>
<tr>
<th>Respondent 's Identifier</th>
<th>Compliant Efforts (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 2B</td>
<td>If the case were that we could save some money, I would definitely reallocate resources and make changes to save us money.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>Yes, agree.</td>
</tr>
<tr>
<td>Company 1</td>
<td>For me, company 1, I would probably continue doing what I'm doing because there are other areas I need to be compliant in. However, what I would change is...to look at how can I pull all of this together and say, &quot;this is my code of ethics&quot;.</td>
</tr>
<tr>
<td>Company 3</td>
<td>I think, to summarize what everybody said and what I would do if I were clearly doing more than required to meet the standards for ethics, for the code of ethics, I would do a review and streamline the process and get rid of any unnecessary processes. Or, if it involved resources, reallocate the resources. But make sure you remain 101% compliant.</td>
</tr>
</tbody>
</table>

Although the question is primarily for companies that have mature ethics programs, the facilitator allowed all participants to reply, assuming a “what if” scenario. This question addresses a concern that companies investing in ethics-awareness activities might scale back their efforts to mere compliance with the FAR in an effort to cut cost or reallocate resources. The implication would be a possible overjustification effect wherein the company would lose its pre-existing
intrinsic motivation to establish an ethical environment, because the extrinsic value of compliance would become the priority. (See complete discussion of survey question 15.)

Three of the four participants above indicate they would scale back efforts to the point of compliance in order to save money or reallocate resources. Only Company 1 stated it would not change anything because the efforts are required for the maintenance of certain professional certifications. These results are in stark contrast to responses to the corresponding survey question where only seven percent of the responders indicated they would consider reducing compliance efforts. The focus group responses, however, are in line with the researcher's assumption that small businesses would reduce efforts to save resources.

*Opinion of Government’s Policy Change - Focus Group Questions 2B, 6A, 7A, 7B, 8A, 9*

Questions in this final grouping focused on the participant’s opinion of government's policy changes pertaining to federal acquisitions. Specifically, the inquiries attempted to unveil the participants' perception of the impact the changes may have on their business activities.
Focus Group Question 2B: Does the FAR provide clear guidance on how to comply with the new requirements? Explain your answer. (Maps to Survey Question 20)

Table 4.28. Responses to Focus Group Question 2B

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Clarity of Ethics Requirements (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 2A</td>
<td>[Vague]. The FAR just tells you to be honest. That’s it.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>I think you’ll find in the FAR the terminology [is confusing]. What is timely manner? Credible evidence, what is that? It’s never really clear. The government wants to cover their… but we want to be safe too. So we need more direction so we stay out of troubles.</td>
</tr>
<tr>
<td>Company 3</td>
<td>When you get a contract, and I had experience with this recently, you look at all the clauses that are included by reference. If that [ethics] clause is not included in the contract, it’s a tossup on whether or not you have to follow that clause. (The contracting officer has to very carefully pick the clauses that are included.) If you’re required to be inspected later on for your ethics program, well, can you tell us if it’s something included in every contract? (Respondent asked for clarification on applicability of rule.)</td>
</tr>
<tr>
<td>Company 1</td>
<td>So, I think that really what happens at the end of the day is you have to figure out how am I going to comply? What will it cost me to comply? To what magnitude [does] my code of ethics have to be to comply? What are all the specific topics that I need to cover? ... So, really it’s not until something happens that you really got to say oh my goodness did I get this right? Once something happens it’s like really did I do this thing right? So I think that, again, it’s on the government. The government got to post it up [clearly] like this: THIS IS THE BIG THING YOU GOT TO BE IN COMPLIANCE WITH!</td>
</tr>
</tbody>
</table>

When asked about the clarity of the requirements, all four participants expressed concern about specific areas that appeared ambiguous or unclear.

Company 2A, for example, found the rule lacking the necessary detail to facilitate comprehension. Company 2B found the terminology to be confusing and concluded the vagueness was an intentional ploy on the part of the government to
allow it the latitude to conveniently interpret or reinterpret the rule in its own favor as needed. Company 3 expressed some anxiety around the applicability of the rule and whether or not the rule would be enforceable if the contracting officer inadvertently failed to incorporate clause 52.203-13 into the contract.

Finally, Company 1 surmises that each individual company will have to try and figure out what is really required to be compliant and hope they get it right. The participant believes confusion could easily be avoided if the government would simply state in a very succinct and clear manner exactly what compliance entails. It is evident from the comments that each company is concerned about their ability to comply because they do not have a firm understanding of the requirement.

The responses from the corresponding survey question were in line with the focus group findings, where the vast majority of respondents felt the rule did not provide sufficient guidance to facilitate compliance.
Focus Group Question 6A:
To what extent do you feel the Government is overstepping its bounds in mandating the establishment of a code of business ethics and conduct for contractors? (Maps to Survey Question 17)

Table 4.29. Responses to Focus Group Question 6A

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Government Overstepping its Bounds? (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 3</td>
<td>I really don’t think they’re overstepping their bounds. I think it’s something necessary and I think it’s oversight on the part of the government who spends taxpayers’ money and a lot of it on goods and services; you should have some indicators. Other than a 100% audit to say this company has good business practices and the way we’re going to measure that is to say take a look at their code of ethics and see to what extent they are implementing that code. I don’t think that’s overstepping their bounds and interfering with company internal operations because they’re not telling you what to do on a day-to-day basis, they’re just telling you that in order to be awarded this contract and take the taxpayers’ money for the services you’re going to provide, you’re going to have to live by a code of ethics. So you can take our baseline and you can develop your own, but we might be looking…we will be looking to see just how well you’re doing the job. So I think that’s a reasonable expectation.</td>
</tr>
<tr>
<td>Company 1</td>
<td>I don’t think that they’re overstepping their boundaries because if something happens it’s going to impact that agency, should something happen to that contractor…it’s for the good of the company and the good of the agency… But I don’t think it’s overstepping their boundaries because it protects both the company and the agency.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>I agree they’re not overstepping their boundaries because they’re handing out $5 million contracts. They don’t want a person that’s lying or bribing to hand over their $5 million contract to. So they have to pick someone [ethical] with a business code of ethics.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>I don’t think they’re overstepping their bounds. I think it makes sense. It is a lot of taxpayers’ money [involved].</td>
</tr>
</tbody>
</table>
The focus group was unanimous in its opinion that the government acted within its authority in mandating that contractors have a code of conduct. Each participant agreed that the government was exercising due diligence and oversight of taxpayer dollars. These findings support the results of survey question 17, where the majority of respondents felt the government did not overstep its boundary. Going into the study, the researcher expected most small businesses to consider the government's actions as not stepping over the line primarily because small businesses were exempt from the more stringent requirements of FAR Clause 52.203-13. As demonstrated, the focus group and survey results align with this assumption.

**Focus Group Question 7A:** As a condition of doing business, is it not reasonable for the Government to mandate the establishment of a code of ethics and influence the design of ethics-related programs for its industry partners? (Maps to Survey Question 19)

Table 4.30. Responses to Focus Group Question 7A

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Reasonableness of Mandate as a Condition of Doing Business (Direct Quotes from Respondents)</th>
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</thead>
<tbody>
<tr>
<td>Company 2A</td>
<td>I think it's fair to mandate a code of ethics.</td>
</tr>
<tr>
<td>Company 3</td>
<td>So, to answer the questions, I think you need some kind of check and balance. You need some oversight. If you don’t have the oversight, you just can’t have a handshake and assume everything is fine because there is too much money involved. Any time there is a lot of money involved, corruption is on the perimeter knocking at the door. So I think it’s better to have a solid, documented code of ethics. [Yes]</td>
</tr>
<tr>
<td>Company 1</td>
<td>It only takes one person to cause a problem that could cost your contract... that could cause you debarment. So it should be a part of every organization regardless of the size. Because whenever you’re</td>
</tr>
</tbody>
</table>
Respondent’s Identifier | Reasonableness of Mandate as a Condition of Doing Business (Direct Quotes from Respondents)  
--- | ---  
Company 2B | dealing with people, you’re going to be vulnerable to something. And I think some of the requirements should be a part of doing business.  
| Generally speaking, I think it’s reasonable.  

Based on responses to the previous question, it is not surprising that all four participants believed the government’s mandating a code of conduct as a condition of doing business was reasonable. This echoed the results of the corresponding survey question where an overwhelming majority of respondent considered the mandate reasonable. This also supports the assumption that the majority of small businesses would conclude that the provisions of the rule were reasonable as a condition of doing business with the government.

It is noteworthy that both company 3 and company 1 shared the conviction that a code of conduct was valuable and essential to the deterrence of corruption. They also stated that people are vulnerable and susceptible to corruption given the right circumstance. Again, this current of thought aligns with Dan Ariely’s theory of dishonesty where he contends that people have the propensity to be dishonest; however, moral suasion tends to be an effective tool in curtailing misconduct. (See discussion in Chapter 3.)

Focus Group Question 7B: Doesn’t this [effort] demonstrate that the government is exercising due diligence in its procurement process? Please provide your answer and explain. (Maps to Survey Question 19)
Table 4.31. Responses to Focus Group Question 7B

<table>
<thead>
<tr>
<th>Respondent’s Identifier</th>
<th>Government’s Due Diligence (Direct Quotes from Respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 3</td>
<td>Company 3 believes that statement is right. The government is exercising due diligence.</td>
</tr>
<tr>
<td></td>
<td>So, if you’re not submitting, [the code], how do you know how compliant I am until there’s an incident? Which gets back to what I was saying earlier about the government being reactive. They don’t ask to see a copy of it upfront. Not yet, I’ll put it that way. Not yet they don’t ask for it because if they do ask for it, then there’s one more thing that they have to review...So I see it more as a good will effort at this point. It’s better to have something than nothing. We’re not going to come after you to see what you have unless you got some other surveillance mechanism out there that’s monitoring. Hopefully they’re monitoring, but the only time I want to see your code of ethics is when something happens.</td>
</tr>
<tr>
<td>Company 1</td>
<td>Now I think it’s good due diligence as long as it’s fair across the board. The problem I have is when it’s not fair. So it has to be fair and reasonable. But you know, the government, they kind of have a way of putting that grey area in things where they can bend it left or bend it right. I think that’s what causes a lot of problem for small businesses. [It] is when they put that grey area in there they can go whichever way they want to go to their advantage. You know, best value, fair and reasonable, those are the kind of clichés. So when you get into compliance and then you start using that kind of flowery language, I don’t think it’s good due diligence then. I think it’s just somebody covering their...you know. So that is where I would have a problem.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>Yes, that’s a great point [that Company 1 made]. As long as it’s clear. “timely manner”, what’s timely manner? The government wants to cover [themselves]... but we want to be safe too. So we need more direction so we stay out of troubles.</td>
</tr>
<tr>
<td>Company 2A</td>
<td>I agree [with the statement]. I think it’s fair to mandate a code of ethics.</td>
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</tbody>
</table>
Company 3 and Company 2A readily agree with the statement that the government's mandate demonstrates its due diligence in overseeing the procurement process. They both consider the requirement to have a code of conduct to be reasonable. However, Company 1 and Company 2B appear skeptical in their assessment. Company 1 questions the government's sincerity because it is mandating a document be established, but it has no intent to conduct a review of the item unless a problem arises. Both companies view the vague and ambiguous language as a loophole for the government to use as needed to interpret or reinterpret the requirement to its advantage. They believe more direct language would serve to facilitate compliance and thus mitigate risk to the contractor.

The majority of respondents to survey question 19, which corresponds to the focus group question, expressed varying degrees of agreement with the statement. Approximately one fifth of the respondents disagreed altogether.

**Focus Group Question 8A**: To what extent does increased regulation adversely affect your willingness to conduct business with the government? (Maps to Survey Question 21)

<table>
<thead>
<tr>
<th>Respondent's Identifier</th>
<th>Impact on Desire to Conduct Business with Government (Direct Quotes from Respondents)</th>
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<tbody>
<tr>
<td>Company 2A</td>
<td>[As a strategy], some companies just want to stay below the $5.5 million; around $4 million just to avoid compliance. [Preference to limit growth rather than deal with compliance issues]</td>
</tr>
<tr>
<td>Respondent ‘s Identifier</td>
<td>Impact on Desire to Conduct Business with Government (Direct Quotes from Respondents)</td>
</tr>
<tr>
<td>-------------------------</td>
<td>----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Company 3</td>
<td>It would be good to limit regulations to the extent possible. But, I don’t think requiring a code of business ethics is over-regulation. If you’re a government contractor it’s not so easy to make that transition to commercial. If you’re a government contractor, that’s what you know and that’s what you do. And, you do it within the parameters of the guidelines. [No impact]</td>
</tr>
<tr>
<td>Company 1</td>
<td>When the security officer comes in [for inspection], there are certain things you got to have; when the ISO auditor comes in there’re certain things you got to have; when you have a GSA audit, there are certain things you got to have, so you know as you stay in this industry over a period of time there are certain things you’re going to be forced to do from here, here, or here.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>Essentially it is another challenge for smaller companies with limited resources, but understanding that it doesn’t really apply until you reach a certain contract size and so forth. I guess the hardship can be mitigated.</td>
</tr>
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</table>

It appears from the responses that the participants intend to continue to operate their federal line of business; however, they offer diverse approaches to functioning successfully in an environment where regulation is fluid. Company 2A, who already expressed concern about its ability to comply in focus group question 4A, proposed a scenario where a company would strategically choose not to bid on contracts in excess of five million dollars to avoid having to comply with the mandate. In this case, the impact to the company would be a change in business strategy that would restrict the scaling of public-sector services. The desire to conduct business with the government would remain, but only in smaller increments.
Company 1 and Company 3 are both resolute in their position as government contractors, accepting regulation as an integral part of the federal environment in which they chose to operate. Company 3 acknowledges that the services and experiences realized in the public sector are not always easily transferrable. One can surmise that increased regulation has little impact, if any, on these companies’ desire to engage in federal business.

Company 2B takes the position that it will not be proactive in obtaining compliance, but will wait until it receives a contract award that is subject to the ethics requirements. The rationale is that once a contract is awarded, it will generate sufficient profit to enable the company to procure the resources needed to bring the ethics efforts into compliance. The problem with this reasoning is that the deadline for compliance is likely to occur prior to the company receiving payment of its first invoice. According to the rule, compliance is required within 90 days of contract award. Invoicing under a contract typically does not begin until 30 days after work on the contract has commenced. (That is often a moving target.) Then, payment may not occur for another 30 to 45 days after the government reviews and approves the invoice. In the end, 75 days could easily pass before the company receives payment and can to begin to hire or purchase the resources to address compliance. This is a risky proposition that some small companies with limited resources may elect to implement.
The focus group responses align with those of the corresponding survey question where the majority of respondents indicated there was little or no impact on their willingness to contract with the government. A small number stated regulation greatly affected their desire to engage in government contracting. The researcher assumed regulation would have minimal impact because a small-business government contractor typically lacks the flexibility to migrate its services to the commercial sector, and it is usually not in position to forfeit a profitable line of business just because it does not want to conform to regulatory statues. The findings from the focus group and survey study support the assumption.

**Focus Group Question 9:** Is there anything else you would like to say about the impact of the ethics requirements on your company? (Maps to Survey Question 16)

**Table 4.33. Responses to Focus Group Question 9**

<table>
<thead>
<tr>
<th>Respondent ‘s Identifier</th>
<th>Impact on Business (Direct Quotes from Respondents)</th>
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<tbody>
<tr>
<td>Company 1</td>
<td>Well, this has helped me to now stop and look at how I can put it all together as [a] code of ethics, rather than saying yes I’m in compliance because I can pull this from here, here, and here. But now, figure out a way to still satisfy these other requirements out here that ask for the same thing that this code of ethics asks for without putting a burden on the employees...So I think just having a process in place that is streamlined and is tight enough that you can use it here, here and here. And it if you got to do any tweaking, it’s minimal. So you’ll be able to comply in case something happens, you’ll be able to say I’m in compliance...So, there are certain things that you have to do within certain time frames. But, getting the annual stuff, you tie it in the beginning of the year. That’s how I do everything. Tie it in with the beginning of the year, you know. Security refresher training – beginning of the year; so you look</td>
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### Impact on Business
(Direct Quotes from Respondents)

<table>
<thead>
<tr>
<th>Respondent ‘s Identifier</th>
<th>Impact on Business</th>
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<tbody>
<tr>
<td></td>
<td>forward to getting all that stuff at the beginning of the year. So now it will be Ethics Training – beginning of the year. So once you sit down and start doing all these beginning- of- the –year signatures, you just sign this one too that you got the ethics!</td>
</tr>
<tr>
<td>Company 3</td>
<td>It’s another compliance item to check off. If you look at any business in government contracting, there’s about 40 or 50 of those. Somebody mentioned earlier the Dept. of Labor you got all of these different rules and regulations you have to comply with then you meet up with the IRS at the end of the year. So that’s just business ethics. I think it has to become just a way of doing business.</td>
</tr>
<tr>
<td>Company 2B</td>
<td>I don’t think requiring a code of business ethics is over-regulation. I think it might cause stress and anxiety in some situations. But you take for instance, when you become a member of the 8(a) program, you have an annual report that you have to submit. And you’d better submit it exactly the way they want it or they’ll kick it back and you have to submit it again. It’s very manpower-intensive. Hub Zone has the same thing. Then you have programs like SDVOSB (service-disabled veteran-owned business) For part of the government you can self certify, but it’s totally abused. We just finished a conference in Pittsburg where they tell you the SDVOSB’s are getting contracts and handing them off to big companies. They don’t even have to stay and manage it. They don’t even have to do like in the 8(a) program where you have to work in your company and manage your company full time. You can just hand it off to one to the big guys and say I’ll just take my 15% pass-through...I think you need some kind of check and balance. You need some oversight.</td>
</tr>
<tr>
<td></td>
<td>I think as a company matures and has more resources they will be able to better handle the [ethics] requirements.</td>
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</table>

The exit question afforded the participants the opportunity to make statements about any aspect of the focus group topic; the responses were quite diverse. Company 1 affirmed the benefit of participating in the focus group; the company received insight into the path it must take to ensure compliance.
Company 3 is already accustomed to complying with agency requirements, and thus views the new ethics provisions as “another compliance item to check off.” Further, the company embraces the effort because of the oversight that it provides, which is desperately needed. Company 2B comments that the ability to comply is greater as a company matures; the participant recognizes there is indeed a cost associated with compliance.

**Implications of the Findings**

The preceding sections provided an analysis of the online survey results, focus group discussion, and public comments from the Federal Register that were in response to the FAR amendments during the proposal phase. The researcher grouped related questions for both the survey and focus group into categories to facilitate analysis: 1. Company size and Dependency on Government Revenue (survey only); 2) New Ethics Requirements of the FAR; 3) Company’s Existing Ethics Program; 4) Compliance with the FAR; and 5) Opinion of Government’s Policy Change. The analysis of the public comments served to validate existing assumptions and formulate the basis for additional ones. The implications by category are provided below.

There was no analysis of the first category, as it was for informational purposes only. Category 2 focused on the respondents’ familiarity with the rule and their perception of its reasonableness and effectiveness. It is noteworthy that
only 30 percent of the survey respondents were confident in their knowledge and understanding of the ethics provisions of the FAR amendment. While the sample is not representative of the entire population, it still speaks volumes in support of the assumption that small-business government contractors lack requisite resources, in terms of time, personnel, and capital, to take a proactive stance and stay abreast of policy matters and changing regulation. As a result, some companies are unaware of the new ethics requirements all together. The focus group discussion further validated this claim. This suggests there are small-business government contractors conducting business, but completely oblivious to their risk of non-compliance with the FAR.

The findings in this category also imply the vast majority of respondents considered compliance with the requirements to be reasonable. However, it is problematic that the findings above indicated less than one third of the respondents were comfortable in their understanding of the changes, yet roughly 85 percent believed compliance was reasonable. This tracks with the researcher’s assumption and earlier finding that government contractors are not apt to admit non-compliance with FAR or suggest in any way that they lack the ability to comply because of the stigma and implications associated with non-compliance. Unfortunately, a business may not address non-compliance until an issue arises, which places that business concern at great risk.
In terms of the effectiveness of the requirements, all focus group participants and 64 percent of the companies surveyed considered the rule (having a code of ethics) to have some level of effectiveness in deterring misconduct. This suggests these companies will comply with the rule not merely as a contractual obligation, but because they have some level of confidence in its effectiveness. The researcher assumed the lack of clarity and inability to enforce would sway the respondents to criticize the effectiveness of the rule. However, the majority of responses received indicated the rule would have varying levels of effectiveness and those that questioned the effectiveness did so not because of the impracticality of enforcement, but because of the insufficiency of the requirement as written. That is, they advocated beyond-compliance measures as being necessary to increase effectiveness.

Category 3 questions inquire about the types of business ethics activities in which the company is engaged. Survey findings revealed 76 percent of the respondents claimed to have an ethics program, which was considerably higher than what the researcher anticipated due to the associated financial burden. The researcher determined through subsequent analysis that the percentage of companies with ethics programs was inflated because the survey did not provide a standard definition of an ethics program. Had the inquiry included the definition of the formal program with internal controls as described in the FAR, the result
would have certainly been much smaller. It is noteworthy that many companies boasting an ethics program did not have a recurring training component as part of their effort. It stands to reason that training is a requisite component for the maintenance of a viable program; merely having a program does not ensure its effectiveness. If small businesses were not exempt, such program would not comply with the stringent FAR ethics awareness program requirements. The finding showed that 83 percent of the survey respondents had a code of ethics and roughly half had a code of ethics and conducted training on a recurring basis. Focus group participants indicated they conducted various ethics-related activities (training, development of employee policies, etc.); however, none of them had an established and documented code of conduct.

The findings highlighted an issue that appears to be prevalent in the small business contracting community. Companies often develop a false sense of security by equating compliance with making a diligent effort. They erroneously believe an earnest attempt at compliance is sufficient. However, with the government’s renewed focus on contractor accountability, any company is subject to arbitrary monitoring; therefore, it is incumbent on the small business to ensure its own compliance. Non-compliance could lead to suspension and debarment.

Category 4 concentrated on compliance with the FAR. According to the results, over 90 percent of businesses responding to the survey indicated they
were compliant with the new ethics requirements of the FAR; however, a follow-up question revealed that 29 percent stated they still had varying degrees of effort to expend in order to comply. The focus group results were very similar in that two of the participants believed their efforts were compliant even though they lacked a formal code of conduct. The other participants were uncertain. The obvious inconsistency is likely due to the same issues raised earlier—government contractors are reluctant to admit incompliance with the FAR because of its implications. Some companies perceive themselves as being compliant as long as they are “doing the best they can,” while other companies sincerely do not understand how to comply.

The findings also indicated a correlation between a company’s regard for a code of ethics and compliance with the rule. Most companies completing the survey that believed a code of conduct was significant to their organization had an established code and were compliant with FAR. Again, all focus group participants considered the code of ethics to be essential, even though they did not have a formal code of ethics document. Most were confident their policies and business practices addressed relevant ethics issues germane to a code of ethics; consolidation was the only missing element. Findings also revealed that 50% of small businesses that considered the code as unimportant did not have a code.
This may indicate that certain businesses will choose not to comply because they consider the requirement futile.

Finally, regarding a beyond-compliance ethics program, the majority of focus group respondents indicated if their ethics efforts exceeded the requirements of the FAR, they would prefer to reduce their effort to the point of compliance and reallocate resources. This is in contrast to the majority of survey respondents who stated they would continue their beyond-compliant efforts despite the requirement for less. This is particularly noteworthy for a small business because of its limited resources and competing priorities that are commonplace in day-to-day operations.

Category 5, the final grouping, concentrated on the small businesses’ opinion on change in government policy as it relates to federal acquisitions. Many of the comments echoed those mentioned above. Mainly, that the companies were concerned about their ability to comply with changes in government regulation due to inadequate resources. Only 30 percent of the survey respondents indicated they were confident in their understanding of the new regulation. The focus group participants identified specific areas requiring clarification. Some companies complained of the administrative and financial burden of increased regulation that they believed demonstrated the government’s insensitivity toward small business. Others confirmed they were unaware of any changes or they just did not
understand the changes or how to comply. However, the majority of respondents believed the government’s intent to raise the ethics bar for government contractors was sincere, and despite increased regulation, they desired to continue doing business with the federal government.

**Summary**

The government has launched initiatives to ensure its industry partners conduct business with integrity and are accountable for their actions. To demonstrate the sincerity of this effort, the government has expanded the scope of actions that trigger suspension and debarment activities. As a result, suspension and debarment activity is on the rise. In FY 14 suspension and debarment actions (to include proposed debarments) were up 7.6% from 4,812 in FY13, to 5179 in FY14. (U.S. Interagency Suspension and Debarment Committee 2015) The trend has continued upward since 2009 when the Interagency Suspension and Debarment Committee (ISDC) first began to track the statistics. The ISDC indicated that the increase in numbers does not represent a more successful program. However, there is pressure for agencies to establish suspension and debarment programs and to utilize the process to protect the interests of the government.

As demonstrated in the findings above, the small-business, government-contractor community faces obstacles that may impede compliance with FAR
ethics requirements, such as not having adequate resources for a formal ethics program or lacking resources to manage new regulation within the organization—staying abreast of and understanding changes, adopting policy changes and planning implementation, and understanding and monitoring the impact. In an environment where the government is demanding increased contractor “accountability and integrity,” the small-business government contractor is at risk of non-compliance. The challenge is for small businesses to successfully align corporate objectives with the ethics objectives of the government and implement the necessary measures to realize those objectives. This requires the application of a beyond-compliance effort. Failure to do so, could ultimately lead to the demise of the company.
CHAPTER 5

CONCLUSION

The federal acquisition process has undergone significant scrutiny and has found itself in the center of a sea change of reform demanding higher standards of ethics and integrity from government contractors. Recent changes to the Federal Acquisition Regulation (FAR), which governs the procurement process for substantially all the executive branch agencies, reflect the government’s resolve to rein in contractors and reinforce the long-established policy requiring the government to conduct business only with contractors having a “satisfactory record of business ethics and integrity.” In 2007 and 2008, the FAR was amended to raise the ethics bar for contractors by incorporating rigorous requirements for the establishment of a code of ethics, an ethics program, internal control system, and ethics training for employees.

The government elected to exempt small-business contractors from the more stringent ethics requirements of the FAR out of consideration for their limited resources and the financial burden associated with compliance. The intent may have been honorable; however, the imposition of only minimal ethics requirements in an environment where the government is aggressively demanding higher ethics and integrity standards for contractors will have an adverse impact on small contracting businesses in the future, unless they proactively implement
beyond-compliance measures to ensure they remain in sync with the government’s ethics agenda.

In addition to incorporating new ethics requirements into the FAR, the government increased the scope of activities that could lead to suspension and debarment from conducting business with the government. Accordingly, debarment and suspension activity has been on the rise since 2009, which should prove particularly troubling to small businesses because they are more likely to face suspension and debarment than their large-business counterparts. This is true for several reasons:

- Their services or products are more expendable (generic).
- They often lack resources for a good legal defense.
- They typically lack a formal ethics program with internal controls.
- They are often unaware of changing legislation and requirements for compliance; therefore, they may be oblivious to their own non-compliance.
- They may not understand how to comply.

An analysis of the study results presented in this paper, though not representative, confirmed that most of the items listed above are prevalent among the participating businesses. Results of both the survey and focus group studies found that many of the companies were engaged in some level of organizational ethics activity; however, companies were still at risk of non-compliance because: (1) they did not understand the new rule and did not know how to comply; (2) they were unaware of the change; (3) they lacked resources to stay abreast of
policy issues and implement relevant changes within their organization; or (4) they believed their “best effort” was sufficient for compliance.

So, what is the significance of this to the small-business community? I believe small-business contractors are subject to the following risk factors in regards to compliance with the FAR ethics requirements:

1. False sense of security: they have an established code so they think everything is fine. Complacency sets in.
2. Ignorance regarding the rule: companies are completely unaware of the rule. Often small businesses lack resources to monitor and stay abreast of these type issues. They may not be aware that the clause is incorporated into their contract by reference.
3. Willful non-compliance: they have no code and they are not concerned because they know the government cannot conceivably enforce (impracticality of enforcement).

Regarding the formulation of a code of business conduct, I contend that many in the small-business community may develop a false sense of security regarding compliance with the rule simply because the business has an established code. The government is not explicit in the content of the code by design to leave the contractor flexibility to create the code based on its industry and experience. As mentioned above, it is not inconceivable that a company could have a code of conduct and still not comply with the spirit of the regulation. Or, the government may achieve having all of its contractors develop a code, but the code may not address market transactions, meaning the government’s objectives would not be met. It appears the major issue is the one Heath raised, and that is that many
ethicists fail to make the distinction between market and administered transactions. In doing so, they often advocate the development of only one code to cover all relations internal and external – administered and market. The advantage of using the market failures approach to business ethics is that it addresses market transactions – transactions between the government and contractor, and it aligns with the tenets of the FAR. As such, this approach ensures compliance with the FAR amendments, whose main goal is to promote fair competition. This also leaves the firm the flexibility to select an appropriate approach to developing a code of conduct for the administered transactions; and there are many options that address these types of relationships.

In this thesis, I have attempted to articulate the severity of FAR compliance issues that are prevalent in the small-business, government-contractor community. Further, I presented a strategy to mitigate inherent risks by advocating beyond-compliance to ensure government contractors stay in sync with the government’s ethics agenda and thus maintain compliance with the letter and spirit of the FAR. In short, small-business government contractors must strive for beyond-compliance as a means to align their objectives with those of the government’s ethics program, and in so doing, protect themselves from adverse actions associated with non-compliance. Adopting and promoting compliance with
a code of business conduct that is based on a market failures approach to business ethics is a first step in achieving that end.

**Next Steps**

This thesis posits the notion that in developing a comprehensive code of business ethics, the small-business government contractor must implement a two-pronged approach: one to address market transactions and another to address administered ones. The thesis establishes the theoretical framework for designing a code of business ethics based on market principles; however, it stops short of providing direction for the actual development of a code, as that is outside the scope of the study. Even so, during the course of completing this project, I have given much thought to the possible content and structure of the code, and thus believe its development and application are logical next steps that will greatly benefit the small business community.

Based on my initial thoughts, I offer a few examples of how ethics topics might be addressed within the context of the thesis. The first sample ethics policy statement seeks to constrain profit-maximizing strategies geared toward manipulating the price mechanism, while the second focuses on curtailing the exploitation of confidential information. Violation of either of the two sample policies would create market failure. The third sample, which is for administered
transactions, demonstrates the shift in focus from market transactions to internal relations.

Sample Policies for Market Transactions

Sample 1: Market Competition

| Employees are prohibited from engaging in or discussing with competitors or potential competitors strategies to circumvent competition. This includes activities such as price fixing or coordinating of bids; limiting production or sale of products for anticompetitive purposes, etc. |

| Treat price levels as exogenously determined. |

In government contracting, the situation may arise where during a limited competition (e.g., requiring just three qualified GSA schedule holders), unscrupulous contractors agree to coordinate their bids to influence the outcome. This policy would be applicable to that type of activity.

Sample 2: Use of Confidential Information of Others

| Employees are strictly prohibited from acquiring or using any confidential information belonging to others [to include bid-related information] without proper authorization. Acceptance and use of confidential information can result in substantial legal obligations and liability for both the employee and the company. |

| Do not engage in opportunistic behavior towards customers or other firms. |

The policy statement for the second sample is intentionally broad to include both customers (government agencies) and competitors. Acquiring and using confidential information about an active procurement or proprietary data on a
competitor could provide an unfair advantage, which might impede fair competition. As such, this activity would not be permissible.

Sample Policy for Administered Transactions

Sample 3: Respect for the Individual

<table>
<thead>
<tr>
<th>Relationships Addressed</th>
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<tbody>
<tr>
<td>Employee-employee</td>
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<tr>
<td>employee-manager</td>
</tr>
<tr>
<td>Employee-owner</td>
</tr>
</tbody>
</table>

The policy statement for the final sample addresses the cooperative nature of internal relations – administered transactions. In fulfilling their obligation to the firm, company personnel are required to exhibit mutual respect across the organization.

My purpose for providing the three samples is merely to offer a point of departure, if you will, for future work in this area. I believe the framework has been established to produce a robust and effective code of business ethics that renders compliance with both the spirit and letter of the FAR ethics requirements, while allowing the firm flexibility in determining how best to address internal transactions. Supplemental research and analysis are required to advance the project to the next logical phase, which would be design and implementation.
APPENDIX A

Georgetown University Institutional Review Board

Date: 2/18/2015
To: Patricia Nichols-Jackson
From: Harley Gould
Institutional Review Board
IRB #: 2014-1270
Title: Ethics Requirements of the Federal Acquisition Regulation (FAR): Impact on Small Business Government Contractors
Approval Date: 2/10/2015
Expiration Date: 2/9/2016
Action: Initial Review - Contingency
Attachments being reviewed:

<table>
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<tr>
<th>Document</th>
<th>Version</th>
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<tbody>
<tr>
<td>focus group invitation</td>
<td>0.02</td>
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<tr>
<td>IC form Survey</td>
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<td>ICForm Focus Group</td>
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<td>focus group questions</td>
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<td>focus group confirmation</td>
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<td>survey questionnaire</td>
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<td>focus group invitation</td>
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7 documents were reviewed as part of this submission:

Stamped Documents:

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<tr>
<th>Document</th>
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<tr>
<td>ICForm Focus Group.pdf</td>
<td>0.01</td>
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<tr>
<td>IC form Survey.pdf</td>
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</tbody>
</table>

Your above referenced protocol and consent form were approved through expedited review by Dr. Eric Lansbacher, the IRB Chair or a designee, on 2/17/2015. This is to inform you that
you may commence your project.

Any investigator whose project is externally funded must submit the applicable sponsor grant or contract for review and approval by the appropriate sponsored research office of the recipient institution [GU or MPR]. The project cannot proceed without the approval of the sponsored research office.

Approval for this study is through 2/16/2015. The IRB requires that you submit an application for continuing review at the end of the approval period and/or at study completion. Please note that this office will automatically terminate the project on the date stated above, unless reviewed and re-approved by the IRB. **It is the PI's responsibility to submit the application for continuing review and the appropriate IRB forms at least one month before the expiration date.**

Federal law requires registration with ClinicalTrials.gov of all clinical trials supported by federal funding. ClinicalTrials.gov is the National Library of Medicine's clinical trials Protocol Registration System ("PRS"). Similar registration requirements apply for clinical trials subject to FDA regulation. In addition, the International Committee of Medical Journal Editors (ICMJE) requires registration of clinical trials in a public registry prior to enrollment as a condition for consideration for publication. Georgetown University has established a central ClinicalTrials.gov registration process. Please contact the Georgetown University PRS administrator, Patricia Mazar at mazar@georgetown.edu to set up a PRS user account to register clinical trials. The e-mail should contain the principal investigator's full name, department, phone number and e-mail address. Additional information, including an explanation of which clinical trials must be registered, may be found at http://ora.georgetown.edu, http://clinicaltrials.gov, http://prsinfoclinicaltrials.gov and at http://www.icmje.org/lin_trialup.htm

For all DoD sponsored research please make note that you must obtain approval from the DoD human subjects committee as well as the local IRB approval before commencing research on this project.

** If promotional advertisements will be used for patient recruitment, they must be submitted for IRB review and approval prior to their use.

any incentives for participation in research are subject to IRB review and approval as well.

Please remember to:
1. Seek and obtain prior approval for any modifications to the approved protocol.
2. Promptly report any unexpected or otherwise significant adverse effects encountered in the course of this study to the Institutional Review Board within 7 calendar days. This includes information obtained from sources outside MedStar Health Research Institute and Georgetown University that reveals previously unknown risks from the procedures, drugs or devices used in this study.

Please refer to this date and the protocol number listed above when making inquiries concerning this study.

Email Footer
Small Business Contractor Compliance with FAR Ethics Requirements

Welcome to My Small Business Ethics Survey

Dear Executive Manager:

I am conducting a study regarding business ethics and small businesses as part of the requirements for my doctoral degree in Liberal Studies at Georgetown University. Specifically, this survey is designed to learn about how changes to the ethics requirements of the Federal Acquisition Regulation (FAR) impact small-business government contractors and their views about their ability to comply. The survey should take no more than 15 minutes of your time.

You have been chosen for the survey simply because your company is identified as a small business government contractor. This survey is strictly confidential. Only I will see the responses. You will not be identified in any public report based upon this work.

As a small-business government contractor myself, I plan to use the results of this study to influence my development of an alternative approach to business ethics that ensures compliance with the FAR's business ethics requirements. So your cooperation is very much appreciated.

As an incentive for your participation, you will receive a synopsis of the results in aggregate form, and you will be eligible to win a $150 gift card during our weekly drawings. To participate, you must complete the survey by March 20, 2015, which is the survey close date.

Please read the Participant Consent Form on the following page, then select "Yes" to participate.

Thank you for participating in my survey. Your feedback is important!
Small Business Contractor Compliance with FAR Ethics Requirements

Informed Consent for Survey Participation

Georgetown University
Consent to Participate in Research Study Survey

Study Title: Ethics Requirements of the Federal Acquisition Regulation (FAR): Impact on Small Business Government Contractors

Principal Investigator: Patricia Nichols-Jackson     Tel: 703-922-5919

Advisor: Pater Jaworski
Sponsor: N/A

Introduction
You are invited to consider participating in this research study. Please take as much time as you need to make your decision. Feel free to discuss your decision with whomever you want, but remember that the decision to participate, or not to participate, is yours.

If you have any questions, you should ask the researcher who will explain this study to you.

Background and Purposes
This study is being done in order to learn about how changes to the ethics requirements of the Federal Acquisition Regulation (FAR) impact small-business government contractors and their views about their ability to comply. The study is part of the requirements for my doctoral degree in Liberal Studies at Georgetown University. As a small business government contractor myself, I plan to use the results of this study to influence my development of an alternative approach to business ethics that ensures compliance with the FAR's business ethics requirements, which will be of great value to the small-business community as a whole.

Study Plan
I am conducting a study regarding business ethics and small businesses as part of the requirements for my doctoral degree in Liberal Studies at Georgetown University. Specifically, this survey is designed to learn about how changes to the ethics requirements of the Federal Acquisition Regulation (FAR) impact small-business government contractors and their views about their ability to comply. The survey should take no more than 15 minutes of your time.

You have been chosen for the survey simply because your company is identified as a small business government contractor. This survey is strictly confidential. Only I will see the responses. You will not be identified in any public report based upon this work.

As a small-business government contractor myself, I plan to use the results of this study to influence my development of an alternative approach to business ethics that ensures compliance with the FAR's business ethics requirements.

You can stop participating at any time. However, if you decide to stop participating in the study, we encourage you to talk to the researcher first.

Risks
There are very few risks associated with participating in this study. It is possible, but extremely unlikely that this study could cause harm. For example, admitting that one’s company does not have a documented code of ethics presents some level of risk because it could suggest non-compliance with a federal contracting provision. The probability of harm would be very low, however, because the harm could only occur if the contracting officer by some means received this information about a particular company and readily associated that company with a specific contract that contained the ethics provision.
The researcher will try to reduce this risk by maintaining confidentiality by not disclosing personal and company names during the entire process.

**Benefits**
If you agree to take part in this study, there will be no direct benefit to you. However, information gathered in this study may influence my development of an alternative approach to business ethics that ensures compliance with the FAR’s business ethics requirements, which would benefit the small business community as a whole.

**Confidentiality**
Every effort will be made to keep any information collected about you confidential. However, it is impossible to guarantee absolute confidentiality.

In order to keep information about you safe and to protect the confidentiality of data, the Principal Investigator (PI) will assign unique numbers to each participant, and use the identifiers during data collection, storage, analysis, and reporting. The key linking the numbers to the identifiable data will be contained in an encrypted EXCEL spreadsheet and stored on a secure server. Only the PI will have access to the data.

Your name or other identifiable information will not be included in the final report and doctoral thesis that result from the research project. Please note that, even if your name is not used in publication, the researcher will still be able to connect you to the information gathered about you in this study.

The Georgetown University IRB is allowed to access your study records if there is any need to review the data for any reason.

Please note that the Principal Investigator will personally process all gift card prizes to maintain confidentiality.

**Payment**
Participants will receive a synopsis of the final report on an aggregate level. Also, each participant will be entered into a weekly drawing for a $150 gift card.

**Your Rights As A Research Participant**
Participation in this study is entirely voluntary at all times. You can choose not to participate at all or to leave the study at any point. If you decide not to participate or to leave the study, there will be no effect on your relationship with the researcher or any other negative consequences.

If you decide that you no longer want to take part in the study, you are encouraged to inform the researcher of your decision. The information already obtained through your participation will not be included in the data analysis and final report for this study.

**Questions or concerns?**
If you have questions about the study, you may contact Patricia Nichols-Jackson at 703-322-6919 or pn26@georgetown.edu. You may also contact the researcher’s faculty advisor, Peter Jaworski at p81@georgetown.edu.

Please call the Georgetown University IRB Office at 202-687-1566 (8:30am to 5:00pm, Monday to Friday) if you have any questions about your rights as a research participant.
Consent of Participant

I understand all of the information in this Informed Consent Form.

I have gotten complete answers for all of my questions.

I freely and voluntarily agree to participate in this study.

* 1. Please Select Preference Below:

   [ ]
### Small Business Contractor Compliance with FAR Ethics Requirements

**Section 1 - Business size/type: small business government contractors with revenue > $5 million**

1. What is your company’s average revenue over the past 3 years?
   - [ ] $< 500,000
   - [ ] $500,000 - $2,499,999
   - [ ] $2,500,000 - $4,999,999
   - [ ] $5,000,000 - $13,999,999
   - [ ] $14,000,000 - $35,000,000
   - [ ] $> 35,000,000

2. What percentage of your annual revenue is from government contracting?
   - [ ] <10%
   - [ ] 10% - 49%
   - [ ] 50% - 80%
   - [ ] >80%

3. How many employees work for your company?
   - [ ] < 49
   - [ ] 50-99
   - [ ] 100-249
   - [ ] 250-500
   - [ ] >500

4. Based on your average gross sales over the past three years, is your company considered a small business under your primary NAICS code?
   - [ ]

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### Small Business Contractor Compliance with FAR Ethics Requirements

#### Section 2 - Contractors’ perception of FAR ethics requirements and status of their ethics efforts

In 2007-2008 the FAR was amended to add clause 52.203-13 – Contractor Code of Business Ethics and Conduct, which is to be incorporated into all contracts for non-commercial items in excess of $5,000,000 that endure for greater than 120 days. The clause calls for stringent ethics requirements, including internal controls and an ethics awareness program. However, small businesses are exempt from many of these provisions. Essentially, the clause requires small business government contractors to: (1) have a code of business ethics and conduct (2) promote compliance with the code within the organization and (3) timely disclose any detected criminal activity associated with a procurement.

1. To what extent are you familiar with these ethics requirements?
   - [ ] Not at all familiar
   - [ ] Somewhat familiar
   - [ ] Very familiar

2. To what degree do you believe these ethics requirements of the FAR are reasonable for a small business in terms of compliance?
   - [ ] Very reasonable
   - [ ] Somewhat reasonable
   - [ ] Not at all reasonable

3. How effective do you believe these measures will be in curtailiing business misconduct?
   - [ ] Not effective at all
   - [ ] Somewhat effective
   - [ ] Very effective

4. Does your company have an ethics program?
   - [ ] Yes
   - [ ] No
   - [ ] I don’t know
5. Does your company have a code of business ethics and conduct?
   - [ ] Yes
   - [ ] No
   - [ ] I don't know

6. How often do you conduct ethics training within your organization?
   - [ ] Annually
   - [ ] Only during new-hire orientation
   - [ ] At least twice a year
   - [ ] Never
   - [ ] Not Applicable
   - [ ] Other (please specify frequency)

7. Do you believe your company is currently compliant with the FAR ethics requirements?
   - [ ] Yes
   - [ ] No
   - [ ] I don't know

8. If not currently compliant, how much effort would you estimate it would take to attain compliance?
   - [ ] A great deal of effort
   - [ ] A fair amount of effort
   - [ ] Very little effort
   - [ ] Not Applicable

9. How important is a code of business ethics to your organization and its overall operations?
   - [ ] Not important
   - [ ] Somewhat important
   - [ ] Important
   - [ ] Extremely important
   - [ ] Not Sure
10. If your company already has a mature ethics program that exceeds FAR requirements, how likely is it that you would scale back your program to the point of mere compliance in order to reallocate valuable resources?

- Not at all likely
- Somewhat likely
- Very likely
- Not Applicable

11. Has your company or company’s line of government business been noticeably affected by the ethics changes to the FAR?

- Yes
- No

Please Provide a brief Comment
<table>
<thead>
<tr>
<th>Section 3 - Contractors’ perception of government’s new role mandating specific ethics requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>The recent measures the government has taken to promote ethical and lawful business practices are significant and demonstrate a transformation in the government’s approach to addressing the ethical conduct of its industry partners. Please indicate your agreement with the following statements:</td>
</tr>
<tr>
<td>1. The government is overstepping its bounds in mandating the establishment of a code of business ethics and conduct for contractors. It should not be involved in a company’s internal operations to this extent.</td>
</tr>
<tr>
<td>- Strongly agree</td>
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<tr>
<td>- Agree</td>
</tr>
<tr>
<td>- Agree somewhat</td>
</tr>
<tr>
<td>- Disagree</td>
</tr>
<tr>
<td>- Don’t know</td>
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<tr>
<td>2. The government is obviously sincere in its efforts to crack down on fraud and raise the ethics bar for government contractors.</td>
</tr>
<tr>
<td>- Disagree</td>
</tr>
<tr>
<td>- Agree somewhat</td>
</tr>
<tr>
<td>- Agree</td>
</tr>
<tr>
<td>- Strongly agree</td>
</tr>
<tr>
<td>- Don’t know</td>
</tr>
<tr>
<td>3. As a condition of doing business, it is not unreasonable for the government to mandate the establishment of a code of ethics and influence the design of ethics-related programs for its industry partners. It demonstrates that the government is exercising due diligence in its procurement process.</td>
</tr>
<tr>
<td>- Strongly agree</td>
</tr>
<tr>
<td>- Agree</td>
</tr>
<tr>
<td>- Agree somewhat</td>
</tr>
<tr>
<td>- Disagree</td>
</tr>
<tr>
<td>- Don’t know</td>
</tr>
</tbody>
</table>
4. Do you believe the new clause as detailed in Section 2 provides clear guidance on how to comply with the new requirements?

- Yes
- No
- Unsure

5. To what extent does increased regulation adversely affect your willingness to conduct business with the government?

- It has no affect whatsoever.
- It somewhat affects my desire to contract with the government.
- It greatly affects my desire to contract with the government.
Focus Group Questions

Engagement Questions:
1. We all know of and perhaps have read the great literary masterpiece, War and Peace by Tolstoy. It’s amazing that a book with 1200 – 1400 pages (depending on the translation) continues to captivate a reader and maintain its lofty posture as one of the top literary sellers ever.
   Speaking of voluminous books, how many pages do you think there are in the FAR, including the supplements? (Get answer from each person.)

Exploration Questions:
The intent of the study is to collect data regarding the impact the recent Ethics requirements of the Federal Acquisition Regulation (FAR) may have on small business government contractors, and the extent to which they believe they are capable of complying with the amended regulations.
   Ascertain contractors’ perception of the new ethics requirements and status of their ethics efforts.

Provide Background to Group: In 2007-2008 the FAR was amended to add clause 52.203-13 – Contractor Code of Business Ethics and Conduct, which is to be incorporated into all contracts for non-commercial items in excess of $5,000,000 that endure for greater than 120 days. The clause calls for stringent ethics requirements, including internal controls and an ethics awareness program. However, small businesses are exempt from many of these provisions. Essentially, the clause requires small business government contractors to (1) have a code of business ethics and conduct, (2) promote compliance with the code within the organization, and (3) timely disclose any detected criminal activity associated with a procurement.

2. To what degree do you believe these ethics requirements of the FAR are reasonable for a small business in terms of compliance? And does it provide clear guidance on how to comply with the new requirements? Explain your answer.

3. How effective do you believe these measures will be in curtailing business misconduct? How important is a code of business ethics?

4. Please discuss current ethics programs or efforts that are ongoing at your company, including the existence of a formal code of business ethics and conduct. Do you believe your efforts are compliant, why or why not?
5. If your company already has a mature ethics program that exceeds FAR requirements, how likely is it that you would scale back your program to the point of mere compliance in order to reallocate valuable resources? Please explain

*Ascertain contractors’ perception of the government’s new role mandating specific ethics requirements.*

The recent measures the government has taken to promote ethical and lawful business practices demonstrate a transformation in the government’s approach to addressing the ethical conduct of its industry partners.

6. To what extent do you feel the government is overstepping its bounds in mandating the establishment of a code of business ethics and conduct for contractors? Should the government be involved in a company’s internal operations to this extent? Or, should self-regulation suffice?

7. As a condition of doing business, is it not reasonable for the government to mandate the establishment of a code of ethics and influence the design of ethics-related programs for its industry partners? Doesn’t it demonstrate that the government is exercising due diligence in its procurement process? Please provide your answer and explain.

8. To what extent does increased regulation adversely affect your willingness to conduct business with the government? To what extent does increased regulation create stress, anxiety, or even strained customer relations?

Exit Question

9. Is there anything else you would like to say about the impact of the ethics requirements on your company?
REFERENCE LIST


———. 2015. "Federal Acquisition Regulation; Definition of "Multiple-Award Contract"." Federal Register 80, no. 251 (December 31):81887. Washington, DC.


U.S. Interagency Suspension and Debarment Committee. 2015. FY14 Report by the Interagency Suspension and Debarment Committee on Federal Agency Suspension and Debarment Activities. Washington, DC.


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