Business Ethics
Concepts & Cases

Manuel G. Velasquez

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Chapter Four

Ethics in the Marketplace

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Definition of Market

- A forum in which people come together to exchange ownership of goods; a place where goods or services are bought and sold.

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Three Models of Market Competition

- **Perfect competition**
  - A free market in which no buyer or seller has the power to significantly affect the prices at which goods are being exchanged.
- **Pure monopoly**
  - A market in which a single firm is the only seller in the market and which new sellers are barred from entering.
- **Oligopoly**
  - A market shared by a relatively small number of large firms that together can exercise some influence on prices.

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Equilibrium in Perfectly Competitive Markets

- Equilibrium point: In a market, the point at which the quantity buyers want to buy equals the quantity sellers want to sell, and at which the highest price buyers are willing to pay equals the lowest price sellers are willing to take.
- Principle of diminishing marginal utility: generally each additional unit of a good a person consumes is less satisfying than each of the earlier units the person consumed.
- Principle of increasing marginal costs: after a certain point, each additional unit a seller produces costs more to produce than earlier units.

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Supply and Demand Curves

- **Supply curve:** A line on a graph indicating the quantity of a product sellers would provide for each price at which it might be selling; the supply curve also can be understood as showing the price sellers must charge to cover the average costs of supplying a given amount of a product.

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Supply and Demand Curves

- **Demand Curve**: A line on a graph indicating the quantity of a product buyers would purchase at each price at which it might be selling; the supply curve also can be understood as showing the highest price buyers on average would be willing to pay for a given amount of a product.

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Perfect Competition

- A perfectly competitive free market is one in which no buyer or seller has the power to significantly affect the prices at which goods are being exchanged.
- Perfectly competitive free markets are characterized by seven defining features:
  (1) numerous buyers and sellers and has a substantial share of the market.
  (2) All buyers and sellers can freely and immediately enter or leave the market.
  (3) Every buyer and seller has full and perfect knowledge of what every other buyer and seller is doing.

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Perfect Competition (Cont.)

(4) The goods being sold in the market are so similar to each other that no one cares from whom each buys or sells.

(5) The costs and benefits of producing or using the goods being exchanged are borne entirely by those buying or selling the goods and not by any other external parties.

(6) All buyers and sellers are utility maximizers.

(7) No external parties (such as the government) regulate the price, quantity, or quality of any of the goods being bought and sold in the market.

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Characteristics of Perfectly Competitive Free Markets

- Achieve capitalist justice, but not other kinds of justice like justice based on need.
- Satisfies a certain version of utilitarianism (by maximizing utility of market participants but not of all society)
- Respects some moral rights (negative rights but often not positive rights)

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Characteristics of Monopoly Markets (Cont.)

- Can lead to ignoring the demands of caring and value of human relationships
- Can encourage vices of greed and self-seeking and discourage virtues of kindness and caring
- Can be said to embody justice, utility, and rights only if seven defining features are present.

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Equilibrium in Perfectly Competitive Market

- Price and quantity move to equilibrium in perfectly competitive market because:
  - If price rises above equilibrium, surplus appears and drives price down to equilibrium.
  - If price falls below equilibrium, shortage appears and drives price up to equilibrium.
  - If quantity is less than equilibrium, profits rise, attracting sellers who increase quantity to equilibrium.
  - If quantity is more than equilibrium, prices fall, driving sellers out which lowers quantity to equilibrium.

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Utility in Perfectly Competitive Markets

- Prices in the system of perfectly competitive markets attract resources when demand is high and drives them away when demand is low, so resources are allocated efficiently.
- Perfectly competitive markets encourage firms to use resources efficiently to keep costs low and profits high.
- Perfectly competitive markets let consumers buy the most satisfying bundle of goods, so they distribute goods in way that maximizes utility.

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Rights in Perfectly Competitive Markets

- Perfectly competitive markets respect the right to freely choose the business one enters.
- In perfectly competitive markets, exchanges are voluntary and respects the right of free choice.
- In perfectly competitive markets, no seller exerts coercion by dictating prices, quantities, or kinds of goods consumers must buy.

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Characteristics of Monopoly Markets

- One dominant seller controls all or most of the market's product, and there are barriers to entry that keep other companies out.
- Seller has the power to set quantity and price of its products on the market.
- Seller can extract monopoly profit by producing less than equilibrium quantity and setting price below demand curve but high above supply curve.
- High entry barriers keep other competitors from bringing more product to the market.

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Ethical Weaknesses of Monopolies

- Violates capitalist justice.
  - charging more for products than producer knows they are worth
- Violates utilitarianism.
  - keeping resources out of monopoly market and diverting them to markets without such shortages
  - removing incentives to use resources efficiently
- Violates negative rights.
  - forcing other companies to stay out of the market
  - letting monopolist force buyers to purchase goods they do not want
  - letting monopolist make price and quantity decisions that consumer is forced to accept

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Oligopolistic Markets

Definitions

- Major industrial markets are dominated by only a few firms.
- Oligopolistic markets are "imperfectly competitive" because they lie between the two extremes of the perfectly competitive and monopolistic markets.

Unethical Practices in Oligopolistic Markets

- Price-fixing
- Manipulation of supply
- Market allocation
- Bid rigging
- Exclusive dealing arrangements
- Tying arrangements
- Retail price maintenance agreements
- Predatory price discrimination.

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The Fraud Triangle

- The pressures or strong incentives to do wrong, such as organizational pressure, peer pressure, company needs, personal incentives
- The opportunity to do wrong, which includes the ability to carry out the wrongdoing, being presented with circumstances that allow it, low risk of detection
- The ability to rationalize one's action by framing it as morally justified.

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Main Views on Oligopoly Power

- Do-nothing view.
  - Do nothing since power of oligopolies is limited by competition between industries and by countervailing power of large groups
  - Oligopolies are competitive and big U.S. companies are good international competitors.
- Antitrust view.
  - Large monopoly and oligopoly firms are anticompetitive and should be broken up into small companies
- Regulation view.
  - Big companies are beneficial but need to be restrained by government regulation.

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