

Accounting, Finance, Sustainability, Governance & Fraud:  
Theory and Application

Jing Bian

Kıymet Tunca Çalıyurt *Editors*

# Regulations and Applications of Ethics in Business Practice

 Springer

# **Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application**

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Jing Bian · Kıymet Tunca alıyurt  
Editors

# Regulations and Applications of Ethics in Business Practice

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Jing Bian

I would like to thank Dr. Jing Bian for her excellent contribution to the book and also members of International Group on Governance Fraud Ethics and CSR for their support since 2009. I would like to present this book to memory of Assoc. Prof. Dr. Zakiah Muhammaddun Mohamed who passed away during our publication of this book.

*Condolences on the passing of Assoc. Prof. Dr. Zakiah Muhammaddun Mohamed. It is with our deepest sorrow that we announce the passing of Assoc. Prof. Dr. Zakiah Muhammaddun binti Mohamed, a Senior Lecturer at the School Of Accounting, Faculty of Economics and Management, on Friday, 7 April 2017,*

*at her residence in Petaling Jaya. The deceased was laid to rest at Bukit Kiara Muslim Cemetery. Condolences to the family. May her soul be blessed and placed among the believers.*



**Associate Professor Dr Zakiah Muhammadun Muhamad**

Kıymet Tunca Çalıyurt

# ISBN

This book series is formal book series of International Group on Governance Fraud and Social Responsibility founded by Prof. Dr. Kıymet Tunca Çalıyurt in 2009 in Edirne, Turkey.





# Contents

## Part I Theoretical Issues

<b>1</b>	<b>Negotiating Boundaries: Ethical Issues in Commercial Translation</b> . . . . .	<b>3</b>
	Dongning Feng and Fan Yang	
<b>2</b>	<b>Possible Outcomes for Whistleblowers After They Speak Out</b> . . . .	<b>13</b>
	Emel Esen	
<b>3</b>	<b>Marketing Ethics and Ethical Issues Related to Marketing Communication</b> . . . . .	<b>23</b>
	Emine Mediha Sayil	

## Part II Sector Standards and Professional Ethics

<b>4</b>	<b>Ethics in Health Sector: Global Approach</b> . . . . .	<b>41</b>
	Kıymet Tunca Çalıyurt	
<b>5</b>	<b>The Emerging Role of Managerial and Accounting Ethics for Creating a Corporate Ethical Structure in Organizations</b> . . . . .	<b>63</b>
	Neşe Çoban Çelikdemir and Melisa Erdilek Karabay	
<b>6</b>	<b>Analysing the Effects of Unethical Culture and Organizational Commitment on Employees' and Managers' Unethical Behaviours: Evidence from Turkish Insurance Industry</b> . . . . .	<b>77</b>
	Melisa Erdilek Karabay, Meral Elçi and Özgür Akpınar	
<b>7</b>	<b>Ethics in the Auditing Company</b> . . . . .	<b>97</b>
	Ayşe Pamukcu and Nevber Zeynep Eroğlu	
<b>8</b>	<b>Teaching Ethics in Adult Education</b> . . . . .	<b>115</b>
	Ying Zheng and Yuan Lu	

<b>9</b>	<b>Conflicts of Interest and Improvement Measures in Lawyers' Practice</b> . . . . .	131
	Hong-you Sun and Yuan Lu	
<b>Part III Economic Justice and Professional Ethics</b>		
<b>10</b>	<b>Privacy Policy and Security Issues in E-Commerce for Eliminating the Ethical Concerns</b> . . . . .	153
	Ayşegül Donmaz	
<b>11</b>	<b>Ethics in Finance in Emerging Markets</b> . . . . .	165
	Bogdana Vujnović-Gligorić, Sanel Jakupović and Vedran Šupuković	
<b>12</b>	<b>Business Ethics and Chinese Overseas Investment</b> . . . . .	207
	Jing Bian and Frank Marchione	
<b>Part IV Country Analysis</b>		
<b>13</b>	<b>Precepts of Business Ethics on the Romanian Market</b> . . . . .	227
	Larissa Batrancea, Anca Nichita and Ioan Batrancea	
<b>14</b>	<b>Business Ethics: Theory and Practice in an Islamic Context</b> . . . . .	257
	Siti Faridah Abdul Jabbar, Hasani Mohd Ali, Zakiah Muhammaddun Mohamed and Faridah Jalil	
<b>15</b>	<b>Securities Market in India: Regulation of Undesirable Practices by the Securities and Exchange Board of India</b> . . . . .	273
	Harpreet Kaur	
<b>16</b>	<b>UN Global Compact and Code of Conduct: The Case of Turkey</b> . . . . .	295
	Arzu Ozsozgun Caliskan	
<b>17</b>	<b>Ethical Evaluation of the Duty to Report Patients Crimes in Turkish Psychiatric Practice</b> . . . . .	311
	Okan Çalıyurt	
	<b>Author Index</b> . . . . .	321
	<b>Subject Index</b> . . . . .	323

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**Prof. Dr. Kıymet Tunca Çalıyurt** is a Professor in Faculty of Business Administration and Economics, Trakya University. She graduated from the Faculty of Business Administration and Economics, Marmara University, Istanbul, Turkey. Her master’s and Ph.D. degrees are in Accounting and Finance from the Social Graduate School, Marmara University. She holds Certified Public Accountant (since 2000) and Certified Fraud Examiner (since 2005) titles. She studied with Prof. David Crowther during her postgraduate study in London Metropolitan University on corporate social responsibility in accounting (2004). Her research interests are in accounting, auditing, fraud, social responsibility, corporate governance, finance, business ethics with a special interest in NGOs, aviation management, and agricultural companies. She is the Founder and President of the *International Group and Conference Series on Governance, Fraud, Ethics and Social Responsibility (IGonGFE&SR)*. She has published papers and chapters both nationally and internationally on fraud, social responsibility, ethics in

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# List of Figures

Fig. 4.1 Frequency of schemes based on industry. *Source* ACFE. Association of Certified Fraud Examiners. Fraud Resources. 2016 Report to the Nations on Occupational Fraud and Abuse. <http://www.acfe.com/rtn2016.aspx> . . . . . 45

Fig. 4.2 Anti-fraud controls used in fraud victim companies. *Source* ACFE. Association of Certified Fraud Examiners. Fraud Resources. 2014 Report to the Nations on Occupational Fraud and Abuse. <http://www.acfe.com/rtn-download-2014.aspx> . . . . . 45

Fig. 5.1 Ethical decision making . . . . . 68

Fig. 5.2 Ethical responsibilities . . . . . 69

Fig. 5.3 A Hierarchy of CSR (Adapted from Carroll 1991) . . . . . 71

Fig. 6.1 The research model. . . . . 85

Fig. 13.1 Overall scores of the Business Ethics Index (BEI). *Source* BEI scores were retrieved from: Tsalikis and Fu (2010: 82), Tsalikis and Seaton (2007b: 234, 2008a: 923, 2008b: 383, 2014: 211), Tsalikis et al. (2008: 647) . . . . . 232

Fig. 13.2 Detailed scores of the Business Ethics Index (BEI). *Source* BEI scores were retrieved from: Tsalikis and Fu (2010: 82), Tsalikis and Seaton (2007a: 234, 2008a: 923, 2008b: 383, 2014: 211), Tsalikis et al. (2008: 647) . . . . . 233

Fig. 13.3 Four mandatory stages of the tax compliance process. *Source* Designed based on Franzoni (2000: 55) . . . . . 235

Fig. 13.4 Main qualities of professional accountants as CECCAR members. *Source* Adapted based on the “National Code of Ethics for Professional Accountants” (CECCAR 2011) . . . . . 239

Fig. 13.5 Main categories of threats regarding compliance with ethical principles. *Source* Adapted based on the “National Code of Ethics for Professional Accountants” (CECCAR 2011) . . . . . 240

# List of Tables

Table 3.1	Summary of the studies on advertising ethics. . . . .	26
Table 4.1	Fraud examples from health sector. . . . .	47
Table 4.2	Organizational and national precautions against corruption in health sector. . . . .	48
Table 4.3	US figures of criminal healthcare fraud subjects in 2010. . . . .	51
Table 4.4	Types of corruption in the health sector and consequences . . .	53
Table 4.5	UNGC participant Turkish firms in health and pharmaceutical sector & biotechnology . . . . .	58
Table 6.1	Factor analysis of employee unethical behaviour . . . . .	87
Table 6.2	Means, standard deviations, correlations among variables, and alpha reliability . . . . .	88
Table 6.3	Regression results. . . . .	89
Table 6.4	T test for gender groups’ statistics . . . . .	90
Table 6.5	Results of the analyses of variance. . . . .	90
Table 6.6	Results of the Duncan tests: means of employee unethical behaviour for different levels of work experience. . . . .	90
Table 6.7	Results of the Duncan tests: means of unethical culture for different levels of sector experience . . . . .	91
Table 6.8	Results of the Duncan tests: means of employee unethical behaviour for different levels of sector experience . . . . .	91
Table 11.1	Ethics in modern society . . . . .	188
Table 11.2	Ethics of an individual . . . . .	188
Table 11.3	Manifestation of unethical practices of investment advisers in practice. . . . .	198
Table 11.4	Eligible ethical principles in financial trading with stakeholders . . . . .	203
Table 12.1	Chinese companies buying in Europe 2012 . . . . .	209
Table 12.2	Prioritized types of minerals and related products . . . . .	219
Table 12.3	The five-step due diligence framework. . . . .	220
Table 13.1	Variables of the business ethics index . . . . .	231

Table 13.2	Structure of the company sample pool operating on the Romanian market . . . . .	247
Table 15.1	Total resources mobilized by corporate sector in India (amount in INR crore) . . . . .	275
Table 15.2	Nature of investigations taken up and completed by SEBI. . . . .	287
Table 16.1	The UN Global Compact principles . . . . .	299
Table 16.2	Sectorial distribution of active COP status business participants . . . . .	301



# Introduction

## The Development of Business Ethics in the Global Context

“Regulations and Applications of Ethics in Business Practice” is a compilation of papers which is written from the experience and insight of different countries and industries. A number of leading experts and practitioners have contributed to this book.

There are many observable reasons that why the topic of is of importance. In the past, when facing the deficiency or even the failure of law and regulation, business ethics has been assigned a difficult task, which is to monitor, adjust, supervise, and punish the unethical and immoral business. Nevertheless, although being proposed and emphasized from time to time, and being implemented more substantially in the last few decades, it is hard to tell the actual outcomes of business ethics without conducting in-depth scrutiny.

Therefore, this book examines business and occupational ethics in the contemporary world. By exploring the relevant theories, investigating the different requirements laid by various occupations, and analyzing “the good, the bad and the ugly” of the individual country case study, the book presents a full portrait of the relationship between business ethics and development. This book has also drawn from experiences of different jurisdictions; in particular, special attention has been given to the issues and concerns in developing countries. Moreover, the book has a thorough and comprehensive study on several industrial sectors, e.g., accountants, lawyers, bankers, auditors, and educationalists. A further contribution to the literature in this area is that this book particularly benefits from the chapter authors’ intensive experiences obtained from both the academic and the practitioner’s view. Last but not least, apart from the chapters illustrating historical development and theoretical evolution, this book is mainly set in the context of the last few years. By this approach, it can present the development and reforms of business ethics dynamically in different sectors and jurisdictions. Therefore, it provides a set of coherent chapters by scholars and practitioners in this area.

Part II of this book discusses the sector standards and professional ethics. Chapter 2 Investigation of Internal and External Factors Causing Unethical

Behavior of Accounting Professionals by Uyar and Güngörmüş has given a systematic study on the factors resulting in unethical behavior among accounting professionals. The authors have identified that unethical behaviors of accounting professionals and executives play a key role in many business scandals. In their research, the data is collected from practicing accountants in Turkey via an online questionnaire. A total of 219 accountants from various geographical areas within Turkey returned the questionnaires. The chapter has also examined the legal framework in this regard. The authors have concluded that internal factors rather than external ones play an important role in accountants' unethical behaviors; in particular, it is seen that clients have impacts in this regard, and accountants' fear of losing client contributes to unethical behavior. Last but not least, the authors also present the implications of this research on education system, corporations, families, and individuals.

Chapter 3 addresses the issues of managerial ethics and accounting ethics. In *The Emerging Role of Managerial and Accounting Ethics for Creating a Corporate Ethical Structure in Organizations*, Erdilek Karabay and Coban Celikdemir have given their focuses to these two issues, in order to raise the interest of researchers in the relevant fields, in particular in relation to corporate social responsibility. Based on their research, the authors have highlighted that a particular attention is required to confer on the managerial and accounting ethics. They also pointed out that among the approaches to enhance the leaders' focus on stakeholder value creation, development and executive implementation of an effective code of ethics is a must. Furthermore, they argue that "Corporate Ethics Programme" will contribute to maintaining a basic level of moral practice and commitment. Last but not least, the authors suggest that an "Ethics Committee" can be established in an organization where sustainable business practice is regarded as an important element of the company's activities.

In Chap. 4, a unique issue, the relationship between adult training and ethics, has been addressed. In *Teachers' Ethic in Adult Education*, Zheng and Lu, based on their experiences and observation, have delivered an in-depth discussion on this topic from the perspective of adult education. As the authors identified, the importance of teachers' ethics is reflected not only on students but also on the society, because the latter will be influenced by students' conduct. Zheng and Lu also argue that given the special characteristics of adult education, it is important to construct teaching moral in adult education, which includes moral ideal construction, moral principle construction, and moral rule construction.

Chapter 5 provides readers with a critical analysis on the ethical issues within insurance industry. In *Analyzing the Effects of Unethical Culture and Organizational Commitment on Employee and Managers' Unethical Behaviours: Evidence from Insurance Industry*, Karabay, Elçi, and Akpınar examine the interaction between organizational commitment, unethical culture, and unethical behavior of employees and managers in the Turkish insurance sector. The authors have pointed out that the popular organizational strategy for establishing the ethical culture is to provide and maintain happy employees; therefore, organizational commitment is chosen to be examined in this chapter. A survey was delivered to

250 people working in insurance companies in Istanbul, Turkey. Furthermore, according to the authors, there were 180 completed questionnaires in total, after the deficiently and wrongly completed questionnaires were excluded. The authors have highlighted that insurance companies' ethics include the interaction not only between managers and employees but also between companies and society in a broader framework. The authors have concluded, among others, that organizational commitment in insurance companies is found to be much more effective on the managerial unethical behavior; however, organizational commitment has no effect on employee unethical behavior.

Chapter 6 Ethics in the Auditing Company has discussed the ethical concerns of the auditing professionals. Aimed at displaying the importance of the compliance to ethics rules in the auditing company, Pamukcu and Eroglu have conducted a comprehensive research. They have identified that one of the most important aspects of the audit standards is the ethical standard; furthermore, the provision of the benefits expected from the audit profession and the derivation of trustworthy results depends on the compliance to audit standards. In this chapter, a number of important standards have been examined, internationally and nationally. At international level, the relevant requirements produced by the International Organization of Supreme Audit Institutions, International Federation of Accountants, International Internal Auditors Institute are introduced. Furthermore, legal arrangements established in Turkey are examined in this chapter, for instance Professional Moral Rules of Internal Public Auditors, Ethical Principles of the Ministry of Finance Review Committee, General Principals Related to Independent Audit Institutions and Their Auditors.

In Chap. 7, Negotiating Boundaries: Ethical Issues in Commercial Translation, Feng and Yang have discussed a very interesting issue, however being less explored in the past. Readers will have chance to learn about the insight of the relationship between commercial translation and ethics. The authors have pointed out that the concept of professional ethics seems to be hard to pinpoint in commercial translation. In their paper, a close textual analysis of the strategies involved in the transformation during the target text representation is conducted. Furthermore, this chapter has given a particular examination on the Chinese commercial translation; for instance, why the name of the UK supermarket retailer Tesco has been translated into Le Gou (乐购), why the name of the UK DIY giant B&Q has been translated into Bai An Ju (百安居). Feng and Yang have concluded that translation could be used as an opportunity and platform for re-branding and localization of businesses and organizations, and the ethical aspect is a complex issue.

Chapter 8 offers readers an interesting topic, namely marketing ethics. In Sayıl's work Marketing Ethics and Ethical Issues Related to Marketing Communication, among other issues, advertisements which are criticized most from the ethical perspective have been studied. Upon examination on the literature of ethical issues in marketing communication with a focus on advertising ethics, which were published between 2000 and 2015 in leading academic journals, the author has provided readers with a comprehensive view in this regard. One particularly important issue has been addressed in this chapter is the ethical issue when advertising to

children. Sayıl argues that this has been identified as one of the most important topics worthy of academic research in the marketing field. Another interesting point has been raised by the author is that political advertising has been a target for criticism regarding unethical behavior. Last but not least, Sayıl has pointed out that with the development of E-commerce, some practices associated with certain aspects of Internet marketing have raised concerns. This chapter certainly provides a picture of the relevant research in recent years and presents questions for the future research.

Chapter 9 has addressed the important privacy issues under the background of E-commerce. In *Privacy Policy and Security Issues in E-Commerce for Eliminating the Ethical Concerns*, Donmaz has presented a valuable literature review about the privacy and security issues in B2B E-commerce. As identified by the author, the rapid development of information technology raises complex ethical questions about consumer rights and end-user Internet privacy. Based on 24 studies (from 2001 to 2014), by searching keywords “privacy,” “security,” “ethics” and “E-commerce” in Ebscohost, Emerald, Taylor & Francis, and Wiley Online Library databases, the author has concluded that E-commerce ethical issues are different from those in traditional commerce, in terms of manifestation and scope. The author has further concluded that top ethical issues in this area are access, intellectual property, privacy and informed consent, protection of children, security of information, and trust.

In Part III, this book presents a country and regional analysis to readers. Chapter 10 *Ethics in Finance in Emerging Markets* examines the ethical dilemma in the emerging market. Vujnović–Gligorić and Jakupović have conducted a critical examination on the relevant issues. The authors have identified that moral norms and ethical principles of behavior of emerging financial markets are relatively new; therefore, they have experienced little change in their economic activities. In this chapter, the authors explore, among other issues, morality as the cause of the crisis in society, and the impacts of moral and honorable participants on the financial markets. They have argued that moral economy and moral financial markets are looking for a change of consciousness in humans; and the awareness of people cannot be raised by propagation, but need to be fostered through moral education in order to be implemented permanently, starting from childhood. Based on examining the general theoretical determinant of ethics and morality, measures and mechanisms to preserve ethical values in the financial market, ethics of modern society and the individual as an obstacle to investment, Vujnović–Gligorić and Jakupović propose the essential measures to improve ethical values in finance and suggest the key moral principles to tackle the moral crisis in financial markets.

In Chap. 11 *Conflict of Interests and Improvement Measures in Lawyers’ Practice*, Sun and Lu have discussed one of the core significant issues in legal practice, namely conflict of interests. The Chinese legal regime, more specifically, the Lawyers Law, Strengthen the Improvement of Lawyers’ Professional Ethics and Sense of Discipline, as well as the local regulation in Beijing, Shanghai, and Guangzhou have been examined. Based on selected jurisdictions, Sun and Lu have also conducted a comparative study in this area. The authors argue that due to the

deficiency of the current regime, there are many difficulties which lawyers need to face in practice, for instance when managing the conflicts of interest in cases which are brought by clients in different regions. This chapter also predicts that in order to reform the management of conflict of interest in legal practice in China, it is important to build a high degree of trustworthy, mutually beneficial, and independent service providing relationship between lawyers and clients. The authors also present some possible solutions in this chapter.

Chapter 12 offers the readers an insight into the issues related to business ethics in Islamic background. In *Business Ethics: Theory and Practice in an Islamic Context*, Jabbar, Ali, Mohamed, and Jalil have given a thorough study in this area. The authors have pointed out that in Islam, the dilemma whether an act is ethical or not may be resolved by referring to the principles that are enunciated in the Qur'an and Sunnah, which are the primary sources of the Shari'ah (Islamic law); therefore, Islamic business ethics is based on these two sources and provides an essential foundation in the making of ethical business decisions by Muslim individuals and Shari'ah-compliant corporations. Among other issues, this chapter also presents a discussion on business from the Islamic perspective before embarking on Islamic ethics and business. Furthermore, the authors examine how Islamic ethics guide the manner by which business disputes are to be resolved. The readers will benefit from the insight and general guidelines on Islamic ethics provided by the authors in this chapter.

Chapter 13 *Securities Market in India: Regulation of Undesirable Practices* by the Securities and Exchange Board of India provides an insight to the readers with an analysis from Indian perspective. In this chapter, Kaur has examined in depth on the role and function of the Securities and Exchange Board of India (SEBI), in particularly after it being endowed with more powers by the Securities Laws (Amendment) Act, 2014. This chapter has detailed studied the trends in the primary and secondary market and their regulation, for instance the Companies Act 2013, the Securities Contracts Regulation Act 1956, the Securities and Exchange Board of India Act 1992. Kaur also offers readers a discussion on the recent scams and investigations undertaken by SEBI, for instance the Sahara Group Companies case, National Spot Exchange Ltd case, and the Satyam Computers Ltd case. She has pointed out that since the inception in 1992, SEBI has undertaken 1772 cases for investigation and out of them completed 1539 cases. As for the SEBI, Kaur concludes that the SEBI endeavors to regulate and develop securities market so that numbers of manipulations are reduced; on the other hand, with all the new powers challenges before the SEBI have been increased as well.

In Chap. 14, *UN Global Compact and Code of Conduct: The Case of Turkey*, Çalışkan examines that what are the common grounds and differences between the companies' codes of conduct and the UN Global Compact Principles. The author has pointed out that the UN principles are not codes of conduct, but could be accepted as a frame to persuade companies to act according to the globally shared values, while the codes of conduct could be used to deliver the right messages on what good business practices are. Furthermore, using Turkish companies as examples, after gathering information about their codes of conduct from

companies' Web sites, the author has found out that firms have different approaches in establishing their codes of conduct; for instance, some firms prefer to set up their codes in parallel with the UN principles; however, others merely state that they adopt these principles but without any expression about firms' codes of conduct.

In Chap. 15 *Business Ethics and Chinese Overseas Investment*, Bian and Marchione have researched into the legal regime in relation to the ethical operation of Chinese overseas investment. The authors have particularly given their emphasis on whether the notion of "business ethics" has been well implemented by the Chinese enterprises, whether there are effective institutions to tackle this issue, and whether there are efficient law and regulation to supervise and regulate this area. A number of laws, regulations, and industrial guidelines have been examined in this chapter; in particular, the authors have illustrated the development and reform in this area. Bian and Marchione have concluded that, compared with before, currently more consideration has been given to the ethical operation of Chinese overseas investment. They also argue that this issue has not only been placed on the agendas of governmental bodies, industries, civil societies, and academics, but also become an inherent requirement for the successful business. Last but not least, this chapter has pointed out that in terms of the strategy to establish ethical overseas investment, there is a shift from protecting investment and personnel to giving more environmental and other ethical considerations and benefits to the host countries.

In Part IV, this book presents a special topic on whistle-blowing. Among other issues, one perspective could not be ignored is that the protection and safeguard of the whistle-blowers have never been able to achieve a satisfactory level. What shall people do, if they have witnessed or known some serious misconduct or illegal behaviors? Are they well protected, if they decided to disclose the violations? In Chap. 16 "Possible Outcomes for Whistleblowers after They Speak Out," Esen has conducted a thorough examination. The author has analyzed and reviewed the scenarios after the whistle has been blown, internally and externally. According to Esen's research, despite the harmful and risky impacts that the whistle-blowing behavior does not always result in negative outcomes for employees in the organization. Furthermore, the author argues that the employees may more likely to blow the whistle due to increasing skills and abilities, after they have been empowered. Another interesting point has been raised by the author is that there are some cultural differences on whistle-blowing intention. Therefore, the author concludes that there is a need to change the negative attitudes toward whistle-blowers.

As can be seen from above discussion and introduction to the content of each chapter, this book offers analysis on business ethics from different industrial perspectives and regional dimensions. As a result, readers can have a relatively comprehensive insight and understanding of the application and regulation of business ethics at the current time, based on a global view.

Dr. Jing Bian

**Part I**  
**Theoretical Issues**

# Chapter 1

## Negotiating Boundaries: Ethical Issues in Commercial Translation



Dongning Feng and Fan Yang

### 1.1 Introduction—The Role of the Translator Redefined

In investigating the question of translation ethics, the role of translator is a crucial one. It has been an age-old question and subjected to philosophical, academic and professional debate. ‘Lost in translation’ is a catchphrase that characterises the act of translation and alludes to the inevitability of loss of meaning in translation, for which the translator is very often to blame, but seldom made ethically responsible. On the contrary, any ‘gains’ in translation are rarely subjected to either professional or ethical scrutiny. By convention, a translator is perceived as a faithful messenger in between cultures, and in this sense, he is believed to not assume authorship for what he translates; therefore, he should not be held ethically accountable for either the message of the content or its representation. The other side of the coin is that he is regarded as a fully visible agent and should be held responsible for the message he translates as much as any other interlocutor is responsible for what he re-presents (Inghilleri 2012: 144). However, in commercial translation, especially in translation of the brand and service names, product information, and advertisements, the translator does not work alone and it is likely that he is part of a team including other linguistic, artistic and commercial specialists. In this scenario, the translator is invisible and the public seldom realise that it is essentially the work of a translator.

In commercial translation, particularly in brand name and advertising translation, the translator seldom claims ‘authorship’. This, on the surface, echoes Pym’s position on the ethical responsibility of the translator. Pym (2012) recognises the translator’s agency and subjectivity in translation and translation process; however, he argues that a translator is a non-author, since he is not the author of what he translates and thus he is not responsible for that message. This may be particularly true in commercial translation, where the translator no longer occupies a neutral space in between texts,

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but is a part of a team, the sole objective of which is to maximise corporate profits. In this sense, commercial translation, particularly translation of the brand, corporate and service names, is no longer an act that is carried out by agents that are closely related to the translation process and its publication, but a corporate *rebranding*, though the traces of translation are evident in the representation of the source texts. It seems that the translator is in an ethical quandary. On the one hand, in professional practice, the ethical aspects of the activities are clearly manifested in many handbooks of the translation organisations and professional bodies. On the other, they will need to consider the corporate best interest in the process of translation and localisation of its products. Thus a translator, working with other agents in the process will consider and employ far more complex means and strategies at their disposal to enhance and brand names.

## 1.2 Code of Ethics in Translation

In translation, the meaning of ethics is couched in how to define the concept of fidelity to the original (Berman 2000). Berman characterises translation ethics into two categories, i.e. ‘positive counterpart’ and ‘negative analytic’. Positive counterpart refers to the translation that is faithful to the original and retains the foreign. Negative analytic refers to the translation that negates the foreign and assimilates the foreign to the target culture. He argues:

... this positive ethics in turn supposes two things: first a negative ethics, that is, a theory of those ideological and literary values that tend to turn translation away from its pure aim. The theory of non-ethnocentric translation is also a theory of ethnocentric translation, which is to say of bad translation. A bad translation I call the translation which, generally under the guise of transmissibility, carries out a systematic negation of the strangeness of the foreign work. (Berman 1992: 5)

In this regard, Chesterman (2001) classifies translation ethics into five different categories, such as ethics of representation, ethics of service, ethics of communication, norm-based ethics and ethics of commitment. This classification certainly broadened the dimensions of how to instigate the research into the ways of how the concept of ethics can be investigated. Although it is not the intention of this paper to engage in a philosophical argument about translation ethics, a brief review may also offer insights into the ways to untangle this contemporary issue, especially in commercial activities. Pym’s (2012) argument enables us to taking a step further from the current boundary of the discussion by summing up Steiner and Ricoeur’s positions on the argument:

This involves sketching a regional (i.e. non-universal) ethics, intended only for a particular set of social activities, and thus self-consciously unable to make grand pronouncements on any wider humanity. I thus start from the basic idea that whatever the translator does (and here I use the term ‘translator’ to include spoken mediation), it is always grounded in a situation. The activity can only have value thanks to exchange in that situation. Nothing radically new there. However, this means that, from the outset, we cannot engage in talk

about what ‘the (universal) translator’ is or does. When George Steiner claims, for example, that the translator ‘seeks restitution’ as the most noble ethical element of his ‘hermeneutic motion’, I want to know who that translator is, whom they are working for, and what their specific aim is. Or when Paul Ricoeur posits, rather more provocatively, that translators are in some way schizophrenic and work out of fear or even hatred of the foreigner, I sincerely doubt that this can apply to all translators in all cultures at all times, or indeed to some supposedly universal concept of translation, unless we define things tautologically. Rather than start from ultimately facile suppositions about all possible translators, here I attempt to proceed from the kinds of situations in which translators work. (Pym 2012)

Bassnett and Lefevere’s argument of the translator’s role (1990), though deeply seated in a cultural and political paradigm, informs on the complexity of the issue of ethics in translation and can also shed light in investigation of translation ethics in the commercial context. They maintain:

translations are never produced in an airlock where they, and their originals, can be checked against the *tertium comparationis* in the purest possible lexical chamber, untainted by power, time, or even the vagaries of culture. Rather, translations made to respond to the demands of a culture, and of various groups within that culture. (Bassnett and Lefevere 1990)

They continue to argue that ‘from this place of conflicting demands and allegiances, the translator cannot be seen as a mere messenger, apolitical or neutral. His engagement emerges from his involvement in conflicting ideologies and programmes for change’ (Bassnett and Lefevere 1990). For them, translation is seen as a political act, and deeply entwined in sociopolitical and ideological structures.

Tymoczko (2010) also examines the translator’s place of ‘in-betweenness’ in her essays entitled ‘Ideology and the Position of the Translator: in what sense is a translator “in between”?’ Tymoczko questions that a serious weakness of this metaphorical perception of in-betweenness is that it fails to grasp the nature of engagement vis-à-vis translation. She argues that ‘translation as a successful means of engagement and social change like most political actions requires affiliation and collective action’ (Tymoczko 2010). Tymoczko’s construct seems to be a step closer to the model of how commercial translation operates, especially brand name translation, but stops short to investigate the ethical implications of such affiliation and collective action.

Although the above examination from philosophical and socio-political perspectives appears to be a little abstract, it has certainly prepared the ground for professional practice. From the inception of the UNESCO’s document on *Recommendation on the Legal Protection of Translators and Translations and the Practical Means to improve the Status of Translators*, a review of the charters of professional associations reveals there is a narrow ground of commonality, such as the codes of confidentiality and integrity, which stipulates that translators must not accept work beyond their professional competence (Gouanvic 2001). These two features are not translation specific and can be found in the codes of conduct for other professions such as accounting and engineering. Other pan-professional codes require their members to uphold decorum and general good behaviour so as not to tarnish the profession. Other general codes include impartiality in translation and requirement of notifying clients of potential

conflicts of interest. Some professional codes of practice also indicate that a translator must seek client approval before making additions or deletions that are likely to deviate from the original text or interpretation. However, most professional bodies seem to place accuracy as a paramount ethical concern. The following statements sum up this concern. A review of professional codes of practice from various professional translation bodies informs that the concept of ethics at the textual level is centred around the notion of accuracy:

Accuracy for the purpose of this Code means optimal and complete message transfer into the target language preserving the content and intent of the source message or text without omission or distortion.

...

... Interpreters and translators provide accurate renditions of the source utterance or text in the target language. Accurate is defined for this purpose as optimal and complete, without distortion or omission and preserving the content and intent of the source message or text. Interpreters and translators are able to provide an accurate and complete rendition of the source message using the skills and understanding they have acquired through their training and education.

... Interpreters and translators do not alter, add to, or omit anything from the content and intent of the source message.

... Interpreters and translators acknowledge and promptly rectify any interpreting or translation mistakes.

... Where circumstances permit, interpreters and translators ask for repetition, rephrasing or explanation if anything is unclear. (AUSIT Code of Ethics and Code of Conduct 2012)

However, the concept of accuracy is highly dependent on interpretation, as Levý puts it,

because of the incongruence in linguistic material, perfect agreement of meaning between expressions in the translation and those in the original is not possible... therefore interpretation is necessary. (Levý in Wilss 2001: 108)

This nature of translation seems to subvert the concept of fidelity in translation, especially where artistic poetics and the concept of textual ethics are involved. Translation of corporate names and advertisements seems to be more so compared with translation other types of texts.

### 1.3 Gained in Translation: When a Name Is not just a Name

It is well recognised that the brand name impacts on the perception of the corporate, saleability of the product and service. Corporates, be they a company, or a university, or any other types of organisations, are increasingly becoming aware of their names as assets. As a consequence, much attention has been drawn to their translation and localisation in their target markets. Undoubtedly well-translated local names can open up the target market and contribute to the success of a business and inappropriately translated names will tarnish the product, service and business as can be demonstrated

in this research. However, the issue of professional ethics has seldom been called into question.

A brief review of the evolution of the history of translation strategies applied to translations of brand and corporate names can inform on the changes and ethical implications of such an important commercial activity. In the past, the conventional strategies were largely phonetic translation or literal semantic translation. This strategy is primarily in the form of phonetic transcoding, which is still popular and adopted in translating certain brand and corporate names. A positive example would be the translation of the brand name: Pierre Cardin (Pi'ai'er Kadan [皮埃尔卡丹]), which gives a foreign and glamorous feel to the product image in the Chinese market and represents quality and sophistication. This strategy maximises the translator's presence and visibility, which is, according to Venuti (1995), an ethical behaviour. However, a review of recent translation strategies informs on an increasing diversity of tendencies in brand name translation—a by-product of globalisation.

With the rapid growing integration of the world economy and China's accession to the WTO, China is seen as a huge potential market for many foreign manufacturers and companies. There has been an expansion of commercial communication in the form of translation and rebranding for this market. It is commonly recognised that translated names of brands, products and services play a critical part in the success of the business in the target market.

This paper aims to examine the translations of brand names including higher education institutions, names of commercial organisations, brand names and other commercial materials. It brings into focus the related ethical implications thus to question and problematise the existing concepts of translation ethics.

There has emerged a trend of moving away from conventional translator-led translation process to a more complicated process of translation and redesigning of the image and narrative of the names and products. The importance of brand identity as equity in the target market has been recognised throughout the business world, and large sums of funds have been invested in designing a brand name and its associated image. Much research has been conducted to examine the effectiveness of brand name and equity value it brings to a corporate, service or a product in both commercial and academic fields. Although the translation of brand names has increasingly been coming under scrutiny by corporate artists and designers and has become an integrated part of corporate brand building, its ethical implications have not been rigorously investigated.

The fact that some institutions revamped their foreign translations of the institutional names and some corporations went to great lengths to create a localised corporate name speaks volumes about the significance and importance of the brand and corporate names. This phenomenon calls for a re-examination of the ethical issues surrounding such a practice.

## 1.4 The Chinese Case

In the Chinese–English context, the translation strategies and approaches have seen a remarkable diversification and transformation in the past decades; particularly, since China started to open up its market for various services, companies and institutions market its products and services abroad.

There is evidence that corporations, when branding the companies, spare no efforts in getting their names right. Take Exxon for example, a team composed of linguists and other specialists spent six years and \$1.4 million and carried out research in over fifty countries. It is also becoming evident fewer and fewer companies will leave such an important aspect of their corporate image building to chance, especially when they are planning to expand into other potential markets. More dimensions are to be taken into consideration in translating the company's name into other languages, especially into non-phonetics-based hieroglyphic language like Chinese, which include considerations in cross-cultural communication, commercial implications, corporate image and sociolinguistic acceptability in the target language culture to the maximum effect. The strategies can be generally summed up into three different categories:

- (1) Strategies in this category were largely based on phonetic translation, as illustrated in the above example, or literal semantic translation. This type of strategy is based on the source text phonetics and literal semantics, which has the advantage of transmitting an exotic resonance and meaning of the original, respectively, depending on which strategy is applied, i.e. phonetic or semantic. The disadvantage is it can be obscure to the target market, or the semantics of the translation does not afford the same semantic meaning in the target market, or even transmits a negative connotation in the worst scenario.
- (2) These strategies are based on either a semanto-phonetic or a phoneto-semantic approach, taking advantage of both denotative and connotative meaning of Chinese characters. Strategies that fall into this category are not a new phenomenon; this type of translations is still very much either phonetic or literal semantic oriented, but with increased consideration in cross-cultural communication and sociolinguistic consideration.
- (3) A recent phenomenon informs on an emerging practice that bears resemblance of rebranding and localisation, which takes on much more than a straightforward process of translation. It is less concerned with considerations of translation principles, target language linguistic conventions, commercial regulations, advertising effect and corporate brand building, which has seen an increase in a transformation from translation principle-oriented approach to a corporate image-oriented approach resulting in an increase in carefully considered approximate phoneto-semantic translations less subject to phonetic or semantic constraints.

The current approach to translating corporate and product names basically follows these three strategies. First and foremost is the phonetic approach, i.e. phonetic transcoding—still suitable for product brand or corporate building as demonstrated

by the example of Pierre Cardin. However, combination of possible characters is crucial to this type of translation. Although normally each Chinese character carries meaning by itself, but a combination of characters may not possess a specific meaning. The translated name plays on this nonsensical nature of combined Chinese characters to give it an exotic image, very often Western sounding. This strategy is normally considered ethical in terms of translation ethics, for it retains the original quality. A recent trend for this type of translation takes on a rebranding feature. An obvious consideration for selecting more meaningful Chinese characters was increasingly evident rather than standard transliteration, i.e. phonetic translation.

A proper Chinese name of any multinationals was regarded first and foremost in commercial communication that the corporate has in the target market with potential customers without awareness and knowledge of its original background, history and its associated culture. The translated version is the only vital communication they receive and in some cases combined with corporate visual symbols. Thus, the translation bears an important function of placing the brand into a market, not only aiming at presenting an image of the brand, but also influencing the consumers' behaviour in that particular market. In this sense, translation of corporate names is concurrently a process of rebranding and brand repositioning in the target market. The successful example would be the UK supermarket retailer Tesco—the company name was translated into *Le Gou* (乐购).

According to the conventional phonetic translation, Tesco would be translated into three syllables, i.e. three Chinese characters representing the phonetic components 'te', 's' and 'co'. By convention, an ending consonant is warranted one syllable in Chinese. In this case, the initial consonant was altered from 't' to 'l' and 's' is omitted, and voiceless 'c' becomes a voiced 'g'. It breaks the conventional phonetic translation convention. The strategy used to render this brand name can be called creative semi-phonetic approximation. The translation works well on two levels; firstly on repositioning the brand from a more middle-range customer base to a more popular one, which was recognised by the emerging middle-to-lower-middle class Chinese consumers, due to the fact that in many places the markets are still very popular with ordinary shoppers. The characters (literally meaning 'happy shopping') are in line with the underlying trend in grocery and household goods retail in China, that is 'good value for money', which demonstrates a well-informed brand repositioning strategy in translation. Secondly, the characters represent a cultural image that conforms to a popular 'Chinese' supermarket, and at the same time, the unusual combination gives the name a resonant feel.

Another successful example bears the same characteristics. The Chinese name for the UK DIY giant B&Q was translated into *Bai An Ju* (百安居), which literally means 'hundred safety/peace house or dwelling'. The brand name is accentuated with a commonly recognised lucky Chinese character *bai* (hundred) and Chinese phrase *anju* (peaceful/safe living). The name is vested with a unique traditional Chinese homely feel that strikes the chord of the Chinese psyche and yearning for a cosy home. Although the translation does not have a direct association with the nature of the original business, the translation does not only rebrand the business, but also repositions it for emerging Chinese middle-class consumers who do not

normally engage in DIY, but have it done by trades people. The rebranded name also echoes many Chinese set expressions and has a resonant intertextuality, such as *anju leye* (安居乐业) literally meaning peaceful living and happy working. ‘*Ju*’ is also a character that was often used to mean ‘shop’ in traditional Chinese commerce. Thus, the translated name acquires extra cultural and commercial dimensions in the target market and is built on nostalgia of the Chinese tradition, as well as a foreign brand that imparts a sense of quality and trust. I call this extra dimension *qualitative enrichment*, a term parodied from Berman’s concept of ‘qualitative impoverishment’. There is little doubt that the translated name contributed to the initial success of the business in China.

Studies show that translators without a business background tend to adopt a predominantly linguistic or normative approach in their translation. On the contrary, a translator with business and marketing knowledge tends to adopt a behavioural approach taking into consideration the human response to markets and to organisational needs and policies and to maximise the potential with linguistic probabilities.

Two comparable UK universities recently revamped their Chinese names. They broke away from the traditional geographical location-based translation conventions. The university names do not back-translate into their corresponding geographical localities, i.e. the names of the town and city. Warwick University and Durham University were re-translated into *Huawei Daxue* (华威大学) and *Dulun Daxue* (杜伦大学), respectively. University rebranding/localisation is a new phenomenon in translation practice as well as in research. Compared with the previous translation (*Wolike Daxue* [沃里克大学] and *Da'erhan Daxue* [达尔汉大学], respectively), the re-translated names are more resonant, easy to remember, using more evocative characters in Chinese, have the feel of a corporate image.

It is inherently difficult to assess the effectiveness of the translation due to a number of uncontrollable variables. It is also problematic to evaluate if the recognition and brand awareness in the target market are due to an effective re-translation and rebranding, or due to the intensity of publicity and advertising. However, a retrospective open-ended questionnaire project shows that returns from the subjects show a lower level of knowledge and awareness of the places (translated by adopting a strict conventional approach) where these universities are located. A linguistic analysis of the re-translation reveals the advantages that these retranslations have over the conventional names in that they possess the quality of brevity, i.e. two characters instead of three, and resonance using characters that are easy to pronounce and memorise.

As the research shows, for other phonetically translated university names (mostly civic universities having the same as the cities) the recognition and evaluation of the translations is heavily dependent upon the reputation of the cities where they are located. Universities, such as Manchester, Edinburgh, Liverpool, Glasgow, Newcastle fare better than Bristol, Leeds, Bath, and Southampton in terms of brand recognition. Both Warwick and Durham fell into the latter category until they rebranded their Chinese names. The old phonetic translations of the two universities did not create the same brand awareness in the target market. In this aspect, Bradford fares particularly poorly and its Chinese translation makes it hard to exert an impact.

The practice of rebranding and re-translation of existing corporate names does bring into debate the question of translation ethics, though some professional codes of practice do allow a source text to be handled differently in translation depending upon whether it is being used as evidence in a court case or in a marketing campaign (ATA 2009). This is also a principle held by the functionalists of translation, according to the *skopostheorie* of translation. It also brings into question the role of the translator in commercial communication. To re-translate a place name for corporate benefits proves to be operationally and financially effective. However, it seems to subvert the concept of faithfulness that anchors translation ethics, especially when a more standard translation is already in existence. This suggests that the target text is manipulated to maximise the intended effect. Although most professional codes of practice do stress accuracy, most of them do not really define fidelity or faithfulness, which leaves ample room for translators, together with other corporate linguists, to have a seemingly unchecked autonomy to manipulate the target texts in this area of translation. However, this practice has met with some new regulations from China's State Administration of Industry and Commerce, which stipulates that all translation and localisation of overseas organisations operating in China should observe a strict phonetic translation of the original. It limits, to a large extent, what a translator can do in terms of rebranding and localising corporate names. This regulation, though of a bureaucratic nature, seems to place all foreign companies on a level playing field, which can be in fact seen as an ethical decision.

## 1.5 Discussion

Finally, the ethical aspect of translation as commercial communication is a complex one, which not only warrants further academic and scholarly investigation, but also professional scrutiny. In this paper, we have seen how translation could be used as an opportunity and platform for rebranding and localisation of businesses and organisations and how it has been used as a tool to further and maximise their commercial interests in the target market. The ethical responsibility of the translator in the commercial world is a subtle one stemming from his role as a highly *visible* agent engaged in commercial communication to an *invisible* member of a team working in a multinational corporation. Textual manifestations of intricate cultural and commercial makeover of the original text inform the importance as well as the complexity of the role of the translator as an ethical agent. As is demonstrated, how far a translator's work is ethically bound in commercial translation, particularly in translating brand names, still calls for further investigation.



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# Chapter 2

## Possible Outcomes for Whistleblowers After They Speak Out



Emel Esen

### 2.1 Introduction

Whistleblowers who act to stop wrongdoing and report these actions both inside and outside of the organization to attract other people's and society's attention have a crucial role in whistleblowing process. As a result of this action, whistleblowers do not always have benefits when they speak out. They sometimes accepted as heroes and sometimes as enemies. The organization cannot behave in a positive manner to the whistleblowers in case this protest damages the corporate reputation. Each organization has different corporate cultures, therefore according to procedures and norms as part of organizational culture, it can be used to punish whistleblowers. They can face different negative consequences such as retaliation, blacklisting, dismissal, harassment.

This study is attempting to understand the importance of whistleblowing from the perspectives of whistleblower cases all around the world. This paper is organized as follows: First of the part of this paper, whistleblowing and whistleblower definitions were given, and then, consequences for whistleblowers after they report were discussed and lastly stories about whistleblowers in different countries in the world were analyzed and investigated by giving comparison among cases.

### 2.2 Definition of Whistleblowing

Whistleblowing has been defined from different perspectives; therefore, numerous definitions about whistleblowing have been done by researchers and scholars in business ethics and management area (Malek 2010, 116). For years, researchers are writing about whistleblowing in order to understand the effects on people, organizations, and societies (Lewis 2011, 71). In general, whistleblowing is "the disclosure by

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organization members (former or current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action” (Miceli and Near 1985, 4). This is the most commonly accepted definition in almost all studies. It is also a voluntary and moral protest by who are willing to correct such misconduct (Domfeh and Bowole 2011, 335). Thus, whistleblowing can be approved as an act of organizational commitment and organizational citizenship behavior rather than disloyalty and deviation (Lewis 2011, 71). By this way, whistleblowing behavior enhances distributive and retributive justice and fairness (Waytz et al. 2013, 1027). Therefore, whistleblowing behavior is a complex and complicated dilemma between the societies’s utility and whistleblowers’ commitment to the organization (Mansbach et al. 2012, 307).

According to the definition about whistleblowing, blow the whistle is a kind of report about wrong things in the organization (Davis 2012, 531). Related study on a large military base of Near et al. (2004), several types of wrongdoing for whistleblowing were defined: stealing, waste, bad management, unsafe situations, sexual harassment, discrimination, and illegal practices (Dasgupta and Kesharwani 2010, 59). If we want to analyze deeply of the definition, there are some elements in the explanation of whistleblowing: sharing information and communication with other parties, usually voluntary activity, focusing on wrong behaviors, and reaching corrective outcome (Mac Nab et al. 2007, 7). There are also some kinds of areas based on whistleblowing decision-making process. These are observations of the wrongdoing, factors that moderate whistleblowing intention and behavior, whistleblowing behavior, and reactions to whistleblowing (Chen and Lai 2014, 2). For whistleblowers, it is not only an act for observing and reporting the behavior, but also correcting misconduct is the main purpose of this action (Lewis 2011, 72). It is also important to determine who is affected and harmed from this action and what wrong behavior in the organization is.

### 2.3 The Role of Whistleblowers in Whistleblowing Process

About the definition of whistleblowing, there are several parties as whistleblower, wrongdoer, complaint recipient, and organization itself involved in whistleblowing process (Caillier 2013, 1021). In this process, whistleblower is a person who speak out and report the wrongdoing both inside (internally) of the organization and also outside (externally) of the organization (Bjorkelo et al. 2011, 207). Miceli and Near (1985) also give a definition about whistleblower: “Occupy organizational roles which officially prescribe whistleblowing activity when wrongdoing is observed” (Ball 2005, 5). Due to moral motive, the whistleblower is accepted as the moral hero who protects society (Vandekerckhove 2011, 22). In another study, Miceli and Near (1992) state that “whistleblower is to an official on a playing field, such as a football referee, who can blow the whistle stop the action” (Johnson 2003, 4).

Whistleblowers who are sometimes viewed as courageous people and heroes of the organization mostly share the information with internal parts of the organization

(Read and Rama 2003, 354; Kelly and Jones, 180, 181). By this way, whistleblowers are also separated as internal whistleblower and external whistleblower. Internal whistleblowers report unethical behavior to an entity inside of the organization as ethics ombudsman or top management, while external whistleblowers report this kind of behaviors to an entity outside of the organization as law enforcement, government, and media (McNab and Worthley 2008, 408; Dasgupta and Kesharwani 2010, 58). External whistleblowers prefer to report outside of the organization in case this wrong behavior threatens the public and the members of this society.

Whistleblowers believe that they should share this information with people who have power to change and stop this illegal, immoral, and unacceptable situations (Miceli et al. 2009, 379). First contact is their managers for whistleblowers to correct the wrong behaviors (Lewis 2006, 77). If we want to make comparison between internal and external whistleblowing, in the case of external whistleblowing, employees can gain more support from the outsiders than insiders (Hedin and Mannsson 2012, 159). If we make analysis between wrongdoer and whistleblower, whistleblower has better position and education than wrongdoers; therefore, he or she is more likely to blow the wrongdoing (Gao et al. 2014, 3). Based on power theories, high skilled and valuable employees are more successful to stop the wrongdoing (Bjorkelo et al. 2011, 209). According to the study of MacNab and Worthley (2008), self-efficacy—related to one's capability to accomplish a certain level of performance—influences the internal whistleblowing behavior in the organization. Therefore, we can say that these employees are also highly competent and respected people.

Some employees can be aware of truth about the business issues, but they do not always want to prefer to share this information with other people especially with top management (Park and Keil 2009, 902). Sometimes, employees may prefer to keep quiet instead of speak out when they make cost-benefit analysis. They may think of psychological and economic costs and benefits of the behavior (Keil et al. 2010, 791). According to the definition of organizational silence, it was defined as “The collective-level phenomenon of doing or saying very little in response to significant problems or issues facing an organization or industry” (Kelly and Jones 2013, 186). According to the Albert Hirschman, when an employee feel that something go wrong in his or her organization, he or she have alternative plan for the action: Sound- voicing about dissatisfaction, loyalty- commitment to the organization and job, exit- have an intention to leave from the organization (Hedin and Mansson 2012, 153).

## 2.4 Consequences and Cases about Whistleblowers in Different Cultures

There are some kind of risks and negative outcomes for whistleblowers. Therefore, they need to identify and weigh these possibilities (Philipsen and Soekon 2011, 743). Any statistics about the results of the whistleblower behavior were identified as 90% of them were later fired or demoted, 27% faced lawsuits, and 26% had psychiatric

and physical care (Fountain 2013, 20). Some whistleblowers met with the decrease in salary, promotion, and tenure (Malek 2010, 117). Thus, reporting wrongdoing and unethical actions to the other people at work consists of risk and blacklist (Bjorkelo et al. 2011, 207).

The whistleblower expects that when they try to blow the whistle, they want to take positive reactions from management, but sometimes retaliation from top management can occur (Uys 2000, 259). Management policies can create isolation and discrimination between employees. The retaliation definition has been used as an outcome of a conflict between an organization and its employee, in which members of the organization attempt to control the employee by threatening to take, or actually taking in response to the employee's reporting, through internal or external channels (Regh et al. 2008, 222). It can occur in different forms such as dismissal, blacklisting, suspension, harassment, and transferring to another place by punishing them (Domfeh and Bawole 2011, 334). Therefore, whistleblowing is associated with risk for employees who witness and report the wrongdoing (Firtko and Jackson 2005, 52). On the other hand, as a negative consequence for whistleblowers, the organization seems whistleblowing behavior as betraying of the organizations' interests (Uys 2008, 906).

Whistleblowing behavior does not always result in negative outcomes for employees in the organization who speak out (Mecca et al. 2014, 161). If employees feel that they were supported and protected by corporate culture, their intention about whistleblowing will increase (Teo and Casperz 2011, 238). Also if he or she feels obligated and responsible, again the intention to blow the whistle will more likely increase (Keenan 2007, 87). Taking approval, support, and respect is the positive reactions to the whistleblowers (Hedin and Mansson 2012, 159). Supportive culture represents empathy, understanding, listening, and respecting to the feelings (Sims and Keenan 1998, 412).

When employees are empowered, they may more likely to blow the whistle due to increasing skills and abilities. In general, whistleblowers are committed to their job, organizational moral values, and the organizational goals, and because of their sensitivity and personal responsibility, they may choose to pursue ethical responsibility and report this wrong action both inside and at the end outside of the organization (Tsahuridu and Vandekerckhove 2007, 109–116). Ethical climate, participatory management, reducing bureaucracy might increase willingness to blow the whistle (Rothwell and Baldwin, 2007, 356). Stansbury and Victory (2009) stated that young and low tenured employees are less likely to blow the whistle on the misconduct, because they perceive less informal prosocial control (Gottschalk 2011, 70). As a result, antecedents of whistleblowing can be categorized as individual and situational factors that affect whistleblowing behavior. Individual factors can be categorized as job performance, organizational position, pay level, education (consistent factors) and gender, age, tenure, and job performance (inconsistent factors); situational factors can be categorized as perceived support, organizational justice, organizational culture, organizational performance, and organizational resources (Vadera et al. 2009, 555).

Studies suggest that among the cultures there are some differences about whistleblowing intention. Some cultures have more positive tendencies than other ones (Keenan 2002, 80). By understanding of Hofstede's culture dimensions, whistleblowing behavior can be predictable based on the cultures of the world (Tavakoli et al. 2003, 50). There are four dimensions of Hofstede's cultural classification: power distance, uncertainty avoidance, individualism, and masculinity. From the cultural perspectives, whistleblowing tendencies may be influenced by individualism and collectivism (Park et al. 2008, 931). Employees who are the member of culture in low individualism and high collectivism have more responsibility, and when they observe wrongdoing in their organization, they are more likely to prefer speak out.

The Time Magazine on December 30, 2002, three women whistleblowers against large organizations as Cynthia Cooper of World-Com, Coolen Rowley of the FBI, and Sherron Watkins of Enron are selected "person of the year" (Regh et al. 2008, 221). At first, they prefer to share information with their executives, and then, their warnings reach to outside of the organization and press. As a result of these actions, Watkins and Cooper were not hired again and they initiate in their own companies, and also, Rowley was not promoted and FBI retired her (Malmstrom and Mullin 2014, 30).

In Sweden, specifically public servants anonymously have the right to blow the whistle, but on the other hand, because of whistleblowing behavior civil servants' status can be decreased, and at the end, they can lose their jobs (Hansson 2012, 4).

In 1973, Stanley Adams was a product manager of Roche in Basel. He discovered documents which indicated that the company was involved in price-fixing to inflate the price of vitamins. He complains his company to European Economic Community. EEC had a faulty to keep Adams' name. He was arrested and charged. His wife committed suicide due to his position. After Adams released in six months, he fled to UK (Ole Baekgard 1984).

Mordechai Vanunu was Israeli nuclear technician. In 1986, he revealed details of Israel's nuclear weapons program to the media. He was arrested and spent 18 years in prison. After he completed this period, there were obstacles on his speech and movement, but he violated these restrictions by giving interviews to the media, and therefore, he sentenced again because of violations.<sup>1</sup>

Jeffrey Wigand became a well-known whistleblower in 1996. He told the truth what he saw and observed as the head of research and development in Brown-Williamson Tobacco Corporation. He stated about his company that manipulated its tobacco mix to increase the amount of nicotine in cigarette smoke. Russell Crowe portrayed Jeffrey Wigand in a film—The Insider.<sup>2</sup>

One of the most current news about whistleblowing is Edward Joseph Snowden's story in 2013. He was an American computer professional in NSA (National Security Agency). While he was working there, he noticed government programs involving

<sup>1</sup>[http://www.huffingtonpost.co.uk/2013/06/10/edward-snowden-whistleblowers\\_n\\_3414345.html#slide=2551247](http://www.huffingtonpost.co.uk/2013/06/10/edward-snowden-whistleblowers_n_3414345.html#slide=2551247); <http://www.theguardian.com/commentisfree/2014/apr/20/israel-mordechai-vanunu-hero-edward-snowden>).

<sup>2</sup><http://www.jeffreywigand.com/bio.php>.

the NSA spying on American citizens. After that, he began to copy top secret NSA documents while at work and share these thousands of classified documents with media. He has been called as hero, whistleblower, or patriot. Now, he lives in an undisclosed location in Russia.<sup>3</sup>

There are also some Canadian whistleblower cases who try to expose serious misconduct, incompetence, and corruption.<sup>4</sup> Edgar Schmidt sued the federal government for failing to take adequate steps to verify whether proposed bills violate the Canadian Bill of Rights and the Canadian Charter of Rights and Freedoms.<sup>5</sup> He was a senior lawyer at the Federal Department of Justice. Schmidt was earning between \$120,000 and \$160,000 per year; today, he does not work for the government. He does not have any regret about his whistleblowing action.<sup>6</sup>

## 2.5 Conclusion

Whistleblowing is an act of reporting shortcomings to correct the problem in the organization. It occurs when some unethical and illegal issues happen and some kind of people-whistleblowers tries to stop wrongdoers in order to terminate wrongdoings in the organization. Whistleblowing is usually accepted as an effective management and ethics management tool for the organization. Therefore, in ethic management, whistleblowers have high responsibility when they are compared with other employees in the organization. The fundamental role of whistleblowers in the organization is to report the wrong behaviors for right moral reasoning.

The purpose of this chapter is to investigate the whistleblowers' position all over world after they blow the whistle. Examining whistleblowers' situation is so important because of negative image of this role in the organization.

There are numerous whistleblowing cases which are resulted in restricting, protection of employees and public interest, practicing laws, and regulations. However, blowing the whistle includes potential and actual risks for whistleblowers. Therefore, one of the important risks is retaliation to whistleblowers. People who behave as whistleblowers are trying to build their new lives, pursuing a new career in a new organization, or staying in prison for years. There are some differences in whistleblowers' attitudes and behaviors between different countries. If we want to make a comparison about whistleblowers' position after they share the information, we should analyze cultural orientation of nations. When we look at the cases about whistleblowing and the position of whistleblowers, usually they meet with negative results.

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<sup>3</sup><http://www.biography.com/people/edward-snowden-21262897>; [http://en.wikipedia.org/wiki/Edward\\_Snowden](http://en.wikipedia.org/wiki/Edward_Snowden).

<sup>4</sup>[http://fairwhistleblower.ca/wbers/canadian\\_wbs.html](http://fairwhistleblower.ca/wbers/canadian_wbs.html).

<sup>5</sup><http://www.cjfe.org/resources/features/update-canadian-whistleblower-edgar-schmidt>.

<sup>6</sup><http://www.nationalmagazine.ca/Articles/November/The-whistleblower.aspx>.

It is needed to change negative attitudes toward whistleblowers. Other people in the organization may not support to whistleblowing and whistleblowers themselves if their corporate culture does not approve that this kind of behaviors is acceptable. Companies should make effort to encourage and at the end protect their whistleblowers. Top management and managers should provide training and continuous improvement to help them about making decision in blowing the whistle. Employers can take proactive approaches to prevent their employees from discrimination and retaliation. By doing this precautions, employers and employees can have more positive results for them and their organizations.

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# Chapter 3

## Marketing Ethics and Ethical Issues Related to Marketing Communication



Emine Mediha Sayil

### 3.1 Introduction

Business world mutations, as well as the change of mentality regarding the way business are done, have led to the necessity of analysing the fairness of this process not only from a judicial point of view, but also from the moral point of view. As a result, a new discipline has been conceptualized—business ethics. *As well as the entire business world, marketing has its own ethics problems* (Muchina and Popovici 2008). Ethics are our belief about what is right and wrong. Although these beliefs may vary from one individual to another or one company to another, ethics and business responsibility are an important part of any company's marketing department. The goals of the marketing department are to target an audience, appeal to that audience, and get the audience to purchase that particular product or service. In doing this, a company must make sure that they are first abiding by all laws and regulations, but they should also strive to be sure that they are acting ethically and honestly (Gilbertson 1999).

Marketing ethics can be considered as moral judgment and behavior standards in marketing practice or moral code or system in marketing area (Gaski 1999). In other words, marketing ethics is the research of the base and structure of rules of conduct, standards, and moral decisions relating to marketing decisions and practices (Lu et al. 1999). In marketing ethics, a special importance is given to the ethical aspects of the entire system of marketing communication, and especially of the communication technique with the largest impact on the public advertising (Muchina and Popovici 2008). Advertisements are one of the ways of marketing which are criticized most from an ethical point of view. Advertising has been criticized for promoting materialism, persuading individuals to buy things they do not need, and providing false or misleading information (Bakir and Vitell 2006).

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One of the other marketing fields in which there is faulty behavior from the ethical point of view is selling. Selling ethics presents a morality framework which guides salespeople in daily routine relation with their customers (Özdemir and Tokol 2009).

Ethics in public relations, ethics in direct marketing, and sales promotion activities are also other ethical issues related to marketing communication. The main ethical problem public relations specialists face is linked to the way in which the ideas they support are structured and presented to the public, so that they are transmitted correctly and express a real situation. In which concerns the activity of sales promoting, there is a series of aspects that can raise ethical problems; for example, aspects regarding the correctitude of the way contests, games and lotteries are organized and taking place, the correct utilization of price reductions, the value and signification of the promotional gifts, and the occasions when they are offered.

On the other hand, the main ethical problems related to direct marketing and electronic communication are linked mainly to the way of utilizing information in databases, protecting information with personal character and the consumers' intimacy, the clarity of the communicated messages, protecting minors, and teenagers (Muchina and Popovici 2008). This paper examines studies in the literature published between 2000 and 2015 in leading academic journals and related to ethical issues in marketing communication with a strong focus on advertising ethics in order to keep researchers as well as practitioners abreast of developments in the field.

### **3.2 Literature Review on Advertising Ethics**

Cunningham (1999) defined advertising ethics as “what is right or good in the conduct of the advertising function. It is concerned with questions of what ought to be done, not just with what legally must be done” (Drumwright and Murphy 2004). Advertisers and their agencies are required to make many difficult moral choices, and it is not always easy to know how to make these decisions. Whatever choices advertisers make, there is no scarcity of third parties (e.g., public interest groups, the Federal Trade Commission, competitors, media commentators) to criticize and/or second guess. Thus, research on advertising ethics has the potential to assist managers and public policy makers as they make very difficult choices about communicating with their respective publics (Zinkhan 1994).

There is a large body of literature on advertising ethics. Among other topics, papers have addressed the ethicality of political attack ads, the use of sexual appeals in print advertising, the use of fear appeals in advertising, lottery advertising, the use of questionable environmental claims to sell products, the use of reference prices in advertising, the use of cookies and spamming in electronic media, advertising that targets children, advertising that stereotypes minorities, and alcohol advertising that specifically targets low-income minority populations (Dean 2005). Additionally, the advent of new technology has enabled new media to explode. Traditional mass media advertising is augmented by nontraditional approaches, such as product placement,

viral marketing, direct marketing, and virtual community marketing on the Web (Drumwright and Murphy 2009).

The literature review on many of these topics is highlighted here and a summary of the characteristics for 34 studies are presented in Table 3.1. The key word “Advertising Ethics” was used while searching for the topic and relied on Ebscohost, Emerald, Taylor & Francis, and Wiley Online Library databases for this literature search.

According to Drumwright and Murphy (2009), from the 1980s through the present, two empirical streams of research on advertising ethics have developed. The larger of the two streams has focused on understanding consumers’ perceptions of potentially objectionable advertising—for example, ads with persuasive appeals, ads with idealized imagery, ads for dangerous products, and ads targeting children. The smaller research stream has focused on examining the views of advertising practitioners largely through scenario analysis. Much of this work has been descriptive as opposed to normative, as has been the case for research in marketing ethics more generally (Drumwright and Murphy 2009).

Debate concerning the nature and effects of advertising that characterized the early literature has continued in more recent years. There has been much research on consumers’ understanding of companies’ ethical behavior. Cheung et al. (2013) and Putrevu and Swimberghek (2013) have both focused on sex appeal in advertising. Cheung et al. (2013) studied the effects of the “sexual self-schema” personality trait on Chinese women’s responses to advertisements using sex appeal whereas Putrevu and Swimberghek (2013) studied the influence of religiosity on consumer perception of, and response toward, sexual appeals. Cohan (2001) identifies the ethical issues involved with women’s advertising and argues that ads can be successful in generating sales without portraying women as things or as mere sex objects, and without perpetuating various weakness stereotypes.

In their study, Gulas and McKeage (2000) extend the research regarding the negative impact of idealized images of physical attractiveness on girls’ and women’s self-perceptions to males and add the dimension of financial success. Also they examined the role of attention to social comparison information (ATSCI) in moderating the effects. The ethics of advertising to children has been identified as one of the most important topics worthy of academic research in the marketing field. Hudson et al. (2008), Bakır and Vitell (2006), Lee and Nguyen (2013), Elden and Ulukök (2006) and Preston (2004) studied on advertisements targeting children. Hudson et al. (2008) measure the ethical evaluations of parents in the UK and Canada regarding product placements in children’s films and results show that explicit placements of ethically charged products were perceived as the most unethical type of placements and there was a significant difference in relativism between the two groups. Both sets of respondents would like to see more regulation on the use of placements, especially placements of alcohol, tobacco, and fast foods.

Bakır and Vitell (2006) examine parents’ ethical views of food advertising targeting children and findings indicate that parents’ beliefs concerning at least some dimensions of moral intensity are significantly related to their ethical judgments and behavioral intentions of food advertising targeting children as well as the perceived

**Table 3.1** Summary of the studies on advertising ethics

SQ	Article	Authors	Year and country	Method	Keywords	Journal
1	The Ethics of Advertising for Health Care Services	Yael Schenker, Robert M. Arnold & Alex John London	2014, USA	Conceptual	Media, Organizational Ethics, Professional-patient relationship, Cultural studies	The American Journal of Bioethics, 14:3, 34-43
2	Legal and Ethical Challenges of Online Behavioral Targeting in Advertising	Alexander Nill & Robert J. Aalberts	2014, USA	Conceptual	Online behavioral targeting (OBT), Ethical challenges, Online advertising	Journal of Current Issues & Research in Advertising, 35: 126-146
3	The Ethics of Distress: Toward a Framework for Determining the Ethical Acceptability of Distressing Health Promotion Advertising	Stephen L. Brown & Demian Whiting	2014, UK	Conceptual	Advertising, Health promotion, Ethics, Distress, Fear	International Journal of Psychology, Vol. 49, No. 2, 89-97
4	Consumers' Attitude Toward Advertising Audit As Marketing Communication Tool: Advertising Ethics	Selma Karabaş	2013, Turkey	Empirical, 385 Respondents	Advertisement ethics, Consumer behavior	Çankırı Karatekin Üniversitesi İktisadi ve İdari Bilimler Fakültesi Dergisi, Cilt: 3, Sayı: 1, ss. 143-157
5	Explicating the Moral Responsibility of the Advertiser: TARES as an Ethical Model for Fast Food Advertising	Seow Ting Lee & Hoang Lien Nguyen	2013, Singapore	Empirical 380 Television & Print Ads.	Fast food advertising, TARES, ethical model, Moral responsibility	Journal of Mass Media Ethics, 28:225-240

(continued)

Table 3.1 (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
6	Differential Effects of Chinese Women's Sexual Self-Schema on Responses to Sex Appeal in Advertising	Mei-Chun Cheung, Agnes S. Chan, Yvonne M. Han, Sophia L. Sze & Nicole H. Fan	2013, Hong Kong	Empirical, 300 Female Respondent	Advertising, Consumer behavior, Survey research, Sex appeal	Journal of Promotion Management, 19:373-391
7	The Influence of Religiosity on Consumer Ethical Judgments and Responses Toward Sexual Appeals	Sanjay Putrevu & Krist Swimberghek	2013, USA	Empirical, 423 of 4334 panelists	Ethical judgments, religious influence, Sexual appeals, Advertising effectiveness	Journal of Business Ethics 115:351-365
8	The Assessment of Consumers' Perception of Ethics Toward Advertisements as A Dimension of Marketing Ethics	Özlem Toluk	2012, Turkey	Empirical, 500 Surveys	Ethic, Marketing ethics, Advertisement, Advertisement ethics	Master Thesis
9	Ethical Perceptions and Attitudes Toward The Advertising Profession	Sibel Hoşut	2011, Turkey	Empirical, 108 of 112 Students	Advertising, Ethics, students, Perception, Attitude	Journal of Yasar University, 22(6), 3699-3711
10	Youth Attitudes Toward Advertisements Depicting Nudity and Alcohol: Ethical Dilemmas in Advertising	Job Dubihlela & Dorah Dubihlela	2011, South Africa	Empirical, 251 of 300 Students	Advertising Dilemmas, Advertising ethics, professionals, Alcoholic advertisements, Nudity in advertisements	South African Journal of Psychology, 41(2), 2011, pp. 207-217

(continued)

Table 3.1 (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
11	An Investigation of Egyptian Consumers' Attitudes Toward Ethical Issues in Advertising	Mohamed M. Mostafa	2011, USA	Empirical 306 Respondents	Arab culture, Attitude surveys, Egypt, Ethics in advertising, Islam and advertising	Journal of Promotion Management, 17:42–60, 2011
12	Alcohol and Tobacco Advertising in Black and General Audience Newspapers: Targeting with Message Cues	Elisia L. Cohen, Charlene A. Caburnay & Shelly Rodgers	2011, USA	Empirical, 928 tobacco- and alcohol-related advertisement	Alcohol & tobacco advertising, Message cues	Journal of Health Communication, 16:566–582, 2011
13	Ethical issues in pro-social advertising: the Australian 2006 White Ribbon Day campaign	Robert John Donovan, Geoffrey Jalleh, Lynda Fielder & Robyn Ouschan	2009, Australia	Empirical, 24 Respondents	Ethical issues, Pro-social advertising	Journal of Public Affairs, 9: 5–19
14	A Comparison of the Ethical Perceptions of Prospective Personal Selling and Advertising Employees	Melissa Burnett, Charles Pettijohn & Nancy Keith	2008, USA	Empirical, 185 Personal Selling Students & 191 Advertising Students.	Ethical perception, Personal selling, Advertising employee	The Marketing Management Journal, Volume 18, Issue 1, Pages 77–83
15	Meet the Parents: A Parents Perspective on Product Placement in Children Films	Simon Hudson, David Hudson & John Peloza	2008, UK and Canada	Empirical, A total of 450 usable responses: 270 from the UK & 180 from Canada	Advertising ethics, Children, Marketing ethics, MES, Product Placement, Parents	Journal of Business Ethics 80:289–304
16	An Analysis of Consumer Complaints about Social Marketing Advertisements in Australia and New Zealand	Sandra C. Jones & Katherine Van Putten	2008, Australia and New Zealand	Empirical, 69 complaints from 2000 to 2004	Social Marketing, Advertising, Ethics, Community standards	Journal of Nonprofit & Public Sector Marketing, 20:1, 97–117

(continued)



Table 3.1 (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
17	Ethics in Advertising: Differences in Industry Values and Student Perceptions	Nancy K. Keith, Charles E. Pettijohn & Melissa S. Burnett	2008, USA	Empirical, 40 Advertising Professionals & 191 Students	Advertising ethics; Ethics of advertising professionals; Ethics of students; Gender and advertising ethics; Length of employment and advertising ethics	Academy of Marketing Studies Journal, Volume 12, Number 2
18	Advertising Ethics: A Field Study On Turkish Consumers	Elif Akagün Ergin & Handan Özdemir	2007, Turkey	Empirical 600 Consumers	Advertising ethics, Use of deception in ads, Cultural stereotyping, Sexual stereotyping, Emotional exploitation	The Journal of Applied Business Research –Volume 23, Number 4
19	Tüketicinin Bilgilendirilmesi Sürecinde Reklam Etiği	Işıl Karpat Aktuğlu A	2006, Turkey	Conceptual	Reklam, Tüketicici, İletişim Süreci, Reklam Etiği, Aldatıcı Reklam, Karşılaştırmalı Reklam	Küresel İletişim Dergisi, sayı 2
20	The Ethics of Food Advertising Targeted Toward Children: Parental Viewpoint	Aysen Bakır & Scott J. Vitell	2006, USA	Empirical 89 of 1020 Survey	Parents, Children, Ethics, Food advertising	Journal of Business Ethics 91:299–311

(continued)

Table 3.1 (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
21	Çocuklara Yönelik Reklamalarda Denetim ve Etik	Müge Elden & Özkan Ulukök	2006, Turkey	Conceptual	Çocuklara yönelik reklamlar, çocuk ve etik, reklam ve denetim, uluslararası mevzuat ve çocuk, Türkiye mevzuatı ve çocuk	Küresel İletişim Dergisi, sayı 2
22	Pop-Ups, Cookies, and Spam: Toward a Deeper Analysis of the Ethical Significance of Internet Marketing Practices	Daniel E. Palmer	2005, USA	Conceptual	Pop-ups, cookies, spam, e-commerce, marketing ethics, privacy, property, autonomy	Journal of Business Ethics 58: 271–280
23	Ethics In Advertising	Canan Ay & Pınar Aytekin	2005, Turkey	Conceptual	Ethics in advertising, deceiving ads, Control of advertising	Öneri. C.6, S.24, 45–60
24	Children's advertising: the ethics of economic socialization	Chris Preston	2004, UK	Conceptual	Advertising, Advertising to children, Economic socialization, Children's marketing, Peer pressure, Children's die	International Journal of Consumer Studies, 28, 4, pp364–370

(continued)

**Table 3.1** (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
25	How Advertising Practitioners View Ethics: Moral Muteness, Moral Myopia, and Moral Imagination	Minette E. Drumwright & Patrick E. Murphy	2004, USA	Empirical, A total of 51 personal interviews were conducted in 29 adv. agencies in 8 cities	Advertising, Advertising practitioners, Ethics	Journal of Advertising, 33:2, 7-24
26	Toward an Analytical Structure for Evaluating the Ethical Content of Decisions by Advertising Professionals	Dan Shaver	2003, USA	Conceptual	Advertising, Business ethics, Ethics, Models, Professional ethics, Social contract theory	Journal of Business Ethics 48: 291-300
27	College Student Attitudes Toward Advertising's Ethical, Economic, and Social Consequences	Fred K. Beard	2003, USA	Empirical, 129 Students	Advertising, Advertising regulation, College students, Consumer skepticism, Ethical consequences, Generation Y	Journal of Business Ethics 48: 217-228
28	An Empirical Evaluation of the Effect of Peer and Managerial Ethical Behaviors and the Ethical Predispositions of Prospective Advertising Employees	Nancy K. Keith, Charles E. Pettijohn, & Melissa S. Burnett	2003, USA	Empirical, 191 Students	Advertising ethics, Advertising firm's Ethical culture, Employees' comfort levels, Employees' ethical behavioral intentions, Peer	Journal of Business Ethics 48: 251-265

(continued)

Table 3.1 (continued)

SQ	Article	Authors	Year and country	Method	Keywords	Journal
29	Ethical Considerations in the Use of Direct-To-Consumer Advertising and Pharmaceutical Promotions: The Impact on Pharmaceutical Sales and Physicians	R. Stephen Parker & Charles E. Pettijohn	2003, USA	Empirical, 77 of 363 Staff Physicians	Direct-to-consumer advertising, Pharmaceutical promotions, Physician ethics	Journal of Business Ethics 48: 279–290
30	Advertising Agency-client Attitudes Toward Ethical Issues in Political Advertising	David S. Waller	2002, Australia	Empirical, 101 Adv. Agency Executive and 46 Federal Politicians	Political advertising, Ethics	Journal of Business Ethics 36: 347–354
31	Advertising's Impact on Morality in Society: Influencing Habits and Desires of Consumers	Andrew Gustafson	2002, USA	Conceptual	Advertising, Morality, Consumers	Business and Society Review 106:3 201–223
32	Toward a New Paradigm in the Ethics of Women's Advertising	John Alan Cohan	2001, USA	Conceptual	Ethics, Advertising, Women's Advertising	Journal of Business Ethics 33: 323–337
33	Cultural Influences on Agency Practitioners' Ethical Perceptions: A Comparison of Korea and the USA	Young Sook Moon & George R. Franke	2000, Korea and USA	Empirical 214 of 650 Respondents	Advertising, Advertising Agency, Ethics, Ethical Perception, Cross-cultural	Journal of Advertising, Volume XXIX., Number 1
34	Extending Social Comparison: An Examination of the Unintended Consequences of Idealized Advertising Imagery	Charles S. Gulas & Kim McKeage	2000, USA	Empirical, 143 Male College Students	Advertising, idealized imagery, Attention to social comparison information (ATSCI)	Journal of Advertising, 29:2, 17–28

moral intensity of the situation. Similarly, Lee and Nguyen (2013) studied to identify and explicate the ethical dimensions of fast food advertising to children in Singapore.

Elden and Ulukök's (2006) and Preston's (2004) articles are both conceptual studies which examine arguments for and against children's advertising and related adjustments and regulations. On the other hand, political advertising has long been a target for criticism regarding unethical behavior. In (2002) study, Waller looked at the attitudes of Australian advertising agency executives and politicians toward ethical issues relating to political advertising by surveying 101 advertising agency executives and 46 federal politicians.

Alcoholic and nudity appeals are often used in advertising. Dubihlela and Dubihlela (2011) investigated how the youth are influenced by or respond to advertisements that depict nudity and alcohol and they found that the youth have differing degrees of negative attitudes toward advertisements depicting nudity and alcoholism. They suggest that with careful consideration and planning, it is possible for advertisers to find a common ground and use advertisements without offending people in the process. Cohen et al. (2011) analyzed 928 tobacco- and alcohol-related advertisements from a 3-year national sample of Black and general audience newspapers from 24 US cities. Results suggest that black newspapers may have greater dependency than do general audience newspapers on these risk-related advertisements that target African American consumers. Donovan et al. (2009) examined The Australian White Ribbon Day 2006 campaign which was severely criticized by mental health professionals and those working in the family and domestic violence sector because of depictions of suicide and self-harm in the television advertisement and accompanying promotional materials. They called attention to a number of ethical issues for pro-social organizations when dealing with sensitive issues and using execution techniques that may impact negatively on vulnerable audiences.

Jones and Putten (2008) by reviewing complaints made by members of the general public in Australia and New Zealand to the advertising regulatory bodies in those two countries for the five years 2000–2004 concluded that there is a need for further research to explore “community standards” in relation to social marketing messages and that there is a clear need for social marketers to consider consumer attitudes toward advertising when developing communication strategies and messages. Consumer's attitude toward ethical issues in advertising has also been examined by Karabaş (2013), Toluk (2012), Beard (2003), Ergin and Özdemir (2007) and Mostafa (2011) empirically. The approach developed by consumers against such kinds of advertisements has been studied via data obtained by survey method.

However, Ay and Aytakin (2005), Aktuğlu (2006) and Gustafson (2002) studied on advertising ethics conceptually. In their studies; Ay and Aytakin (2005) evaluated recent examples and trends in Turkish advertising, Aktuğlu (2006) drew attention to the ethical principles that should be taken into consideration by advertising firms in product–consumer communication applications and Gustafson (2002) explored how advertising affects the desires and inclinations of individuals, and then, whether that influence has any moral ramifications. Advertising by health care institutions has

increased steadily in recent years. In their (2014) study, Schenker, Arnold, and London illustrated how common advertising techniques may mislead patients and compromise fiduciary relationships, thereby posing ethical risks to patients, providers, health care institutions, and society. Parker and Pettijohn (2003) examined the influence of direct-to-consumer advertising and physician promotions with some of the ethical issues which may arise when physicians accept promotional products from pharmaceutical companies. Brown and Whiting (2014) discussed how advertisers can approach the problems of deciding on the appropriate intensity of ethical review, and evaluating prospective distressing advertising campaigns against the conditions outlined.

Relatively few studies have examined the views of advertising practitioners in the literature. Of those that exist, most have used scenarios to assess the perceptions of respondents regarding the ethics of certain behaviors and practices. The studies of Moon and Franke (2000), Drumwright and Murphy (2004), Burnett et al. (2008), Hoştut (2011) and Keith et al. (2008) are examples for such type of studies examined in this review. In another study, Keith et al. (2003) evaluated the effect of peer and managerial ethical behaviors and the ethical predispositions of prospective advertising employees and found that peer ethical behavior exerts a strong influence on the comfort or discomfort level and the ethical behavioral intentions of potential advertising employees. Shaver (2003) proposed a model for evaluating ethical content of decisions by advertising professionals.

Finally, while e-commerce has grown rapidly in recent years, some of the practices associated with certain aspects of marketing on the Internet have raised concerns on the part of Internet users. In its conceptual study, Palmer (2005) examined the nature of some Internet-related marketing practices, such as pop-ups, cookies, and spam, and argued that the ethical issues surrounding these Internet marketing techniques move us beyond the traditional treatment of the ethics of marketing and advertising found in discussions of business ethics previously. Nill and Aalberts (2014) studied on online behavioral targeting (OBT), the tracking of a consumer's online activities in order to develop a behavioral profile of the consumer which is a rapidly growing technique that enables advertisers to deliver relevant messages.

### **3.3 Conclusions and Future Study**

Many ethical issues in marketing communication appear to be subject to perpetual debate. Among them advertising is the most visible business tool, exposing the public to thousands of messages each day. Despite attention to issues of advertising ethics through the decades, it would be a mistake to assume that advertising ethics has received coverage commensurate with its importance. While advertising ethics has been recognized for some time as a mainstream topic, research is thin and inconclusive in many important areas (Drumwright and Murphy 2009). Additionally, the overall institution of advertising is being technologically reshaped today, such as electronic advertising. In the early years of this decade, advertising ethics expanded

to concerns about new media such as the Internet. As such, many new questions confront the field of advertising. This review contributes to the literature by providing a holistic picture of advertising ethics issues discussed in the recent years and by identifying promising avenues for future research.

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**Part II**  
**Sector Standards and Professional Ethics**

# Chapter 4

## Ethics in Health Sector: Global Approach



Kıymet Tunca Çalıyurt

### 4.1 Introduction

Mahatma Gandhi talks about seven unethical behaviours in the business world: wealth without work, pleasure without conscience, knowledge without character, commerce without morality, science without humanity, religion without sacrifice and politics without principle (Tankwa 2017). The strength of national economy depends on its corporations being effective and eager (The Committee on the Financial Aspects of Corporate Governance 1992, 10). The business world is affected directly by social, cultural, technological and legal developments. Not only developments within its home country, but also developments outside the borders affect the business world. The developments in the business world along with the progress of digital commerce deeply affected the business processes. Speeding up of commerce, the change in the ways business is conducted, the urge and possibility of reaching the service without leaving the house due to online shopping caused significant changes in payment and collections as well as our lifestyle. Cash, check, bond, credit card or non-monetary payments left their place for virtual platforms. Today, it is not possible to shop without credit cards or virtual payments. The uncontrolled environment that emerged alongside these fast developments caused “corporate frauds” that started in 1980 and climaxed with the Enron scandal in 2001. After these developments, a new subdivision called “fraud examination” was added to “management” science. While it was a problem for the corporate management “how they will attest” to their interest groups how they protect their own company from “fraud”, the solution to this issue was partially attempted by non-financial reporting (sustainability reporting). Corporate managers were directed towards “non-financial reporting” besides financial reporting, and corporate managers and auditors started looking for ways to relay their social responsibility works to their shareholders by way of social responsibility or sustainability reports.

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Corporate governance, besides its many purposes, emerged as a way of “fraud prevention” with the pressure of shareholders that are hurt because of fraud towards governing bodies of business world. The Organization for Economic Cooperation and Development (OECD) published the principles of corporate governance (OECD 2016a). The primary goal of OECD is the increase human welfare and the improvement of economy. It is not possible to ensure success in businesses, to enhance the economical parameters and thus to improve human welfare in countries, where corporate governance is not developed. The OECD website states that corporate governance will not be self-contained and this means economical productivity, sustainable growth and supporting financial stability (OECD 2016b). Corporate governance enables businesses access to long-term capital and fair treatment to the interest groups of the company. The reasons that corporate governance is one of the most talked topics of recent times are:

- ✓ Interest groups losing money,
- ✓ The problems businesses face with accountability towards its interest groups at the end of the operating cycle.

The health sector is a sector that is special among the other seventeen main sectors (PwC 2017). While the others are affected by domestic and foreign developments in a variety of ways, the health sector continues its course without interruption because of “obligatory, urgent, irrecusable” reasons. Alongside this, the health sector appeals to frauds because of supervisory difficulties, it receiving a considerable percentage from the gross national product and the distribution of this percentage being done via public that is not institutionalized, and “fraud and non-budgeted costs after unethical behaviour” emerged as an important problem in the sector.

Important results about fraud in the health sector are revealed in the “Professional fraud and Abuse-Report to the Nations” text that the *Association of Certified Fraud Examiners*, which is the foremost non-government organization in the fight against fraud, prepared based on surveys that they send to fraud examining experts all over the world every two years. According to the ACFE (2016) report, among the 2410 instances of fraud collected from the entire world, the health sector is numbered fifth.

Ethics, which is a concept that has existed since the beginning of human history, has become one of the cornerstones of commercial and social life today. The increase of ethical disagreements has become unavoidable because of the improving commercial life and social relationships becoming more intense. To surpass the ethical dilemmas which are the reasons of said disagreements, again the ethical rules are consulted. At this point, the term “business ethics”, which defines the rules that should be abided by in an ethical sense in order to conduct a business, emerges (Karalar 2016, 80–81). Unethical behaviours in the business world are increasing, and the importance of corporate governance comes to light. Günay and Günay (2016, 187), in their study, stated that capitalism in the world has three major problems. These problems are income inequality, financial crises and global warming. All of these three problems affect the health sector negatively and lead to fraudulent behaviour in the sector, which in turn paves the way to fraud costs. The best course of action which can affect to solve these three problems in the business world is “prevention and audit of fraud”.

Fraud is a transparent snake that silently walks about the business. Because of this snake, the financial cost of Enron and WorldCom scandals could not have been precisely measured. This shows us that the consequences of fraud are only as much as we can observe-catch. Fraud commonly spreads to financial tables transparently, and the auditor cannot notice. This is the reason of companies that fraud occurs in going bankrupt just after they get subjected to audit. Investors suffer the biggest losses after bankruptcies that happen due to fraud. In these situations, share values drop rapidly. According to the study of Kesimli (2016, 278), in the year 2002, the stock market lost 22% in value in the USA after these scandals. After the chain of fraud in USA, the Sarbanes Oxley Law<sup>1</sup> (SOX), which aims to protect investors' rights and companies revealing their data accurately, went into effect in 2002.

In his speech at the American University Kogod School of Business, the executive board member of Public Company Accounting Oversight Board (PCAOB) Steven B. Harris listed the problems they would like to solve with laws as such (Harris 2014):

- The inadequacies with the supervision of accountants,
- Auditors not being independent,
- Weak corporate governance procedures,
- Conflicts of interest of stock market analysts,
- The inadequacy of notification rules,
- The deficiency of Securities and Exchange Commission (SEC) resources in general.

Significant sanctions were brought upon accounting and auditing companies all over the world after the enactment of this law. Turkey was affected by this law as well and established Public Oversight, Accounting and Auditing Standards Authority<sup>2</sup> (POA) in Ankara, leaving all matters of audit and accounting to this institution.

## 4.2 Fraud in the Health Sector: Overview

Health economy is an economical branch that is about expenditures in health and health services, and effectiveness, value and understanding of production. The duty of auditors in the health sector is to increase the quality of service, preservation of assets and increase of quality while fighting against costs. According to Tengilimoglu (2014), the distinguishing characteristics of health institutions are as follows:

- ❖ The identification and measurement of output are difficult.

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<sup>1</sup>Sarbanes Oxley Act of 2002, <https://www.sec.gov/about/laws/soa2002.pdf>.

<sup>2</sup>Public Oversight, Accounting and Auditing Standards Authority, <http://kgk.gov.tr/home>.

- ❖ The works done in health institutions are complex and variable.
- ❖ Most of the works done in health institutions are urgent and irrecusable.
- ❖ The work done is susceptible towards uncertainties, and it cannot be tolerated.
- ❖ The level of specialization in health institutions is quite high.
- ❖ Functional dependency in health institutions is very high. For this reason, a high level of coordination is required between the actions of different professional groups.
- ❖ There is a dual authority line in all health institutions, especially hospitals. This causes coordination, auditing and conflict problems.
- ❖ Human resources in health institutions consist of professionals, and these people prioritize professional goals over institutional ones.
- ❖ An executive and corporate auditing mechanism that has a high impact over the activities of doctors who dictate a large amount of services and health expenditures could not be established.

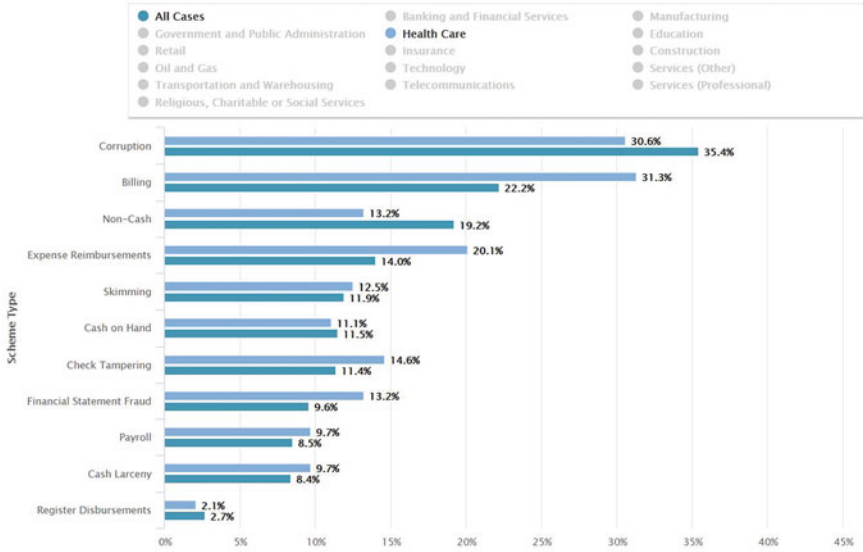
According to the predictions of Laurie Davies of National Health Service,<sup>3</sup> the European Union spends one trillion euros on health and 3–10% of this amount (30–100 billion euros) goes to waste with fraud. In USA, the health sector produces transactions that amount to 2.5 trillion USD. This number is 17.3% of the gross national product in the year 2008. It is expected to reach 20% of the gross national product to 4.3 trillion due to increasing costs and age (Leap 2011, 5). The growing numbers in the health sector also whets the appetites of frauds. Fraud in the health sector, contrary to other sectors, can affect human life directly. Human life can be compromised because of improper drug use, the change in the dose of shots, the changes in prescriptions, improper surgical operations, sale of locations to patients and use of drugs with bribes (Kolaylı et al. 2016). In the health sector, delays can happen in the patient receiving treatment which prevents timely treatment. Among the reasons of treatment being delayed are insufficient amounts of specialists, insurance companies not working with an adequate number of specialists and high-quality doctors not wanting to join the system because of the low pay percentage (Vonderembse 2016, 8–9).

According to the ACFE (2016) report, fraud in the health sector is fifth after banking, public, production and other sectors. The average fraud in the health sector is around 120,000 USD. The anti-fraud controls that are used in sectors that are plagued with fraud are listed as clue, internal supervision, administration review, accidental, balance comparisons, others, documentation examination, external audit, being reported by law and institutions, observation and IT controls. Another important indication in the health sector is that the fraud templates being defined as below.

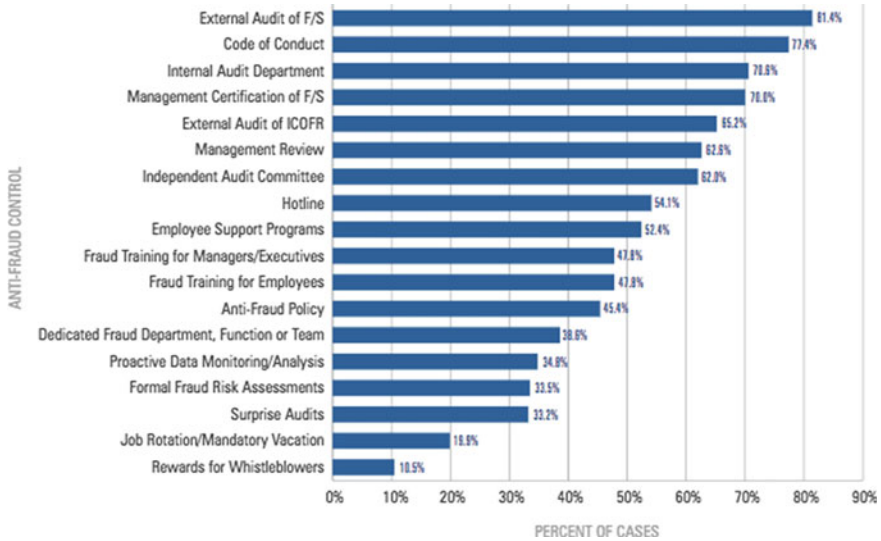
- ✓ Billing frauds,
- ✓ Corruption (bribes, extortion and similar),
- ✓ Withdrawal of expenses (Figs. 4.1 and 4.2).

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<sup>3</sup><http://www.nhs.uk/NHSEngland/thenhs/about/Pages/overview.aspx>.



**Fig. 4.1** Frequency of schemes based on industry. *Source* ACFE. Association of Certified Fraud Examiners. Fraud Resources. 2016 Report to the Nations on Occupational Fraud and Abuse. <http://www.acfe.com/rtn2016.aspx>



**Fig. 4.2** Anti-fraud controls used in fraud victim companies. *Source* ACFE. Association of Certified Fraud Examiners. Fraud Resources. 2014 Report to the Nations on Occupational Fraud and Abuse. <http://www.acfe.com/rtnn-download-2014.aspx>

Fraud in the health sector is a person or an organization gaining a benefit by acting against the regulations, in an unethical way to the detriment of a person or an organization. The types of fraud in the health sector can be listed as, but not limited to, the following:

- ❖ Medical identification theft,
- ❖ Asking for the cost of a service that was not provided,
- ❖ Inclusion of unnecessary services to the bill,
- ❖ Payment collection of the health service by way of the health service getting listed with a different code.

However, the thing that needs to be known is that as the ways of making trade change, fraud tree<sup>4</sup> gets more branches. While the fraud tree that is being published by the ACFE covers general fraud, the preparation of sectoral fraud trees is important with regard to providing solutions to fraud in the health sector. Three cases of health fraud are analysed in Tables 4.1 and 4.2.

### 4.3 Health Sector in USA and Fraud Prevention Methods in the Sector

According to 2012 data, USA, whose health expenditure is 16.9% of its GNP,<sup>5</sup> has the highest percentage among the OECD countries. This percentage was 13.1 in the year 2000 (OECD 2014). The health system of USA is the least egalitarian and the most expensive health system in the world. According to the World Health Organization (WHO), USA is poor when it comes to health services. These unbelievably high health costs are the result of the field of health being transformed into a field of profit. Despite all this expense, the health system does not include the entire society and it is not improving the social health standards. The quality of medical care in the USA is quite high for people who can afford the cost. The best hospitals and medical research institutions are in the country. There are two health insurances with government assistance.

- Medicare (for people who are disabled and/or for people who are over 65),
- Medicaid (for people who are below a certain income level).

Medicare includes people who are over 65 years of age and people who are disabled. In order to benefit from this assistance programme, it is required to be registered in the social security system and to have made ten years of payment.

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<sup>4</sup>Fraud Tree, <http://www.acfe.com/fraud-tree.aspx>.

<sup>5</sup>Gross domestic product (GDP) is a monetary measure of the market value of all final goods and services produced by all resident and institutional units engaged in production in a period (quarterly or yearly). “Residents” are helpful in discriminating the definition from GNP. Gross national product measures production by a country’s citizens at home and abroad rather than its “resident institutional units”.



**Table 4.1** Fraud examples from health sector

Country	Date	Fraudulent case	Results
USA	22 Jan 2004	During fraud audit, the auditing firm PwC <sup>a</sup> identified USD4.6 billion worth of fraudulent accounting practices at Alabama originated rehabilitation clinique HealthSouth. The fraud having started between 1996–2002 and continued until March 2003 comprises unearned increment and other aggressive accounting practices	Including five finance executives, 15 top-level managers of the company had been accused of corruption. Ernst & Young and UBS, the previous investment bank in Warburg, were assumed to be aware of the fraud, and during fraud times, they sold the stocks of the company to investors, but did not inform about financial tables (Dellaportas et al. 2005, 14)
USA	1 June 2012	A federal jury convicted two Miami-area doctors, one Miami-area therapist and two others for their participation in a Medicare fraud scheme involving more than USD205 million in fraudulent billings by American Therapeutic Corporation, a mental healthcare corporation. The announcement was done by the Department of Justice, the FBI and the Department of Health and Human Services	For their roles in the fraud scheme, the mental healthcare corporation's four executives were sentenced to 50 years, 35 years, 35 years and 91 months in prison. <a href="https://www.justice.gov/opa/pr/doctors-therapist-and-recruiters-miami-area-mental-health-care-corporation-convicted">https://www.justice.gov/opa/pr/doctors-therapist-and-recruiters-miami-area-mental-health-care-corporation-convicted</a>
USA	Dec 2010	The owner and vice-president of Wayne County Therapeutic Inc. were the leaders in a USD23 million Medicare fraud scheme, which included the filing of false claims for physical and occupational therapy services that were never provided	The two were sentenced to 151 months and 108 months in prison, respectively, and ordered to pay \$6.5 million in restitution. <a href="http://www.acfe.com/article.aspx?id=4294974475">http://www.acfe.com/article.aspx?id=4294974475</a>

<sup>a</sup>PricewaterhouseCoopers, <https://www.pwc.com/>.

Even though entry into the Medicare B programme is possible by personal contributions for people who do not meet these requirements, many poor people and immigrants cannot afford the Medicare additional payment requirements (Taşlı 2007).

Naturally, fraud in the health sector in USA is increasing and many laws were enacted to prevent fraud in this system:

- ❖ The Antikickback Statue,
- ❖ The Stark Law,
- ❖ False Claims Statues,
- ❖ Health Insurance Portability and Accountability Act 1996 (Leap 2011).

**Table 4.2** Organizational and national precautions against corruption in health sector

Country	Date	Content
USA	13 Feb 2017	Concerned about the way that some drug makers report earnings in their financial statements, US Securities and Exchange Commission recently indicated plans to evaluate pharmaceutical industry accounting practices. <i>Ed Silverman</i> . <a href="https://www.statnews.com/pharmalot/2017/02/13/sec-pharma-accounting-allergan/">https://www.statnews.com/pharmalot/2017/02/13/sec-pharma-accounting-allergan/</a>
Myanmar		In Myanmar, Coca-Cola adopts a zero-tolerance policy towards corruption in its operations and also for its value chain—including its bottlers. All drivers driving Coca-Cola trucks carry an anti-corruption card on their person, which highlights Coca-Cola’s commitment towards no bribery or facilitation payments. <a href="https://www.unglobalcompact.org/take-action/action/case-example/113">https://www.unglobalcompact.org/take-action/action/case-example/113</a>
Germany		The Cabinet of Germany passed the act punishing corruption in the healthcare sector more heavily. <a href="http://www.hurriyet.com.tr/saglik-sektorunde-yolsuzluk-cezalari-agirlastirildi-29681417">http://www.hurriyet.com.tr/saglik-sektorunde-yolsuzluk-cezalari-agirlastirildi-29681417</a>
Turkey	Various dates	<ul style="list-style-type: none"> <li>● Right to Information Act,</li> <li>● The Act of Establishment of Board of Ethics for Civil Servants,</li> <li>● Public Finance Management and Control Law,</li> <li>● Public Tender Act,</li> <li>● The Law Regarding the Prevention of Laundering of Crime Revenues,</li> <li>● Amending Statute Regarding Banking Law and Some Other Laws,</li> <li>● Anti-Smuggling Law,</li> <li>● Turkish Criminal Law,</li> <li>● Amending Statute Regarding Turkish Criminal Law No. 5918 and Some Other Laws,</li> <li>● Code of Criminal Procedure,</li> <li>● Law Regarding Associations and Foundations’ Relationships with State Institutions and Organizations,</li> <li>● Amending Statute Regarding Petroleum Market Law,</li> <li>● Amending Statute Regarding Several Laws in Order to Prevent Bribing Foreign Public Officers for International Operations,</li> <li>● National Marker Practice Enacted within Fight against Fuel Smuggling,</li> <li>● Practices under e-State,</li> <li>● Simplification of legislation; reduction of red tape and bureaucracy; studies for the improvement of investment environment for national and foreign investors,</li> <li>● The Prime Minister’s Office Communication Center (BIMER) which receives and pursues complaints and demands of citizens from all over the country,</li> <li>● <a href="http://www.seffaflik.org/Y_Dosyalar/DOSYA/52B_BASBAKANLIK_TEFTIS_KURULU.pdf">http://www.seffaflik.org/Y_Dosyalar/DOSYA/52B_BASBAKANLIK_TEFTIS_KURULU.pdf</a></li> </ul>

(continued)

**Table 4.2** (continued)

Country	Date	Content
OECD		With the help of globalization corruption, that is vital for many countries including ours, browses outside the boundaries and became a problem which is to be handled internationally. As one of the international institutions, which plays a role in handling this problem, OECD worked on <i>OECD Anti-Bribery Convention</i> in 1997. <a href="http://tbbdergisi.barobirlik.org.tr/m2014-114-1417">http://tbbdergisi.barobirlik.org.tr/m2014-114-1417</a>
The Grand National Assembly of Turkey—OECD	2000	<i>OECD Anti-Bribery Convention</i> <a href="https://www.tbmm.gov.tr/etik_komisyonu/belgeler/kanun_4518.pdf">https://www.tbmm.gov.tr/etik_komisyonu/belgeler/kanun_4518.pdf</a>
Ministry of Health	Various dates	Quality Standards in Health <a href="http://www.kalite.saglik.gov.tr/TR,12680/guncel-standartlar.html">http://www.kalite.saglik.gov.tr/TR,12680/guncel-standartlar.html</a>
Pharmaceutical Manufacturers Association of Turkey	2004	Reference Medicine System <a href="http://www.ieis.org.tr/ieis/en/issues/9/fiyatlandirma">http://www.ieis.org.tr/ieis/en/issues/9/fiyatlandirma</a>
Ministry of Health	2015	Communiqué about Pricing Human Medicinal Products file:///C:/Users/calij/Downloads/beseri-tibbi-urunler-teblig-11-12-15_Y2CEVy_s7ZNgu.pdf
Ministry of Health	2003	184 SABİM (Ministry of Health Call Center) provides self-control of health system by simultaneously assessing health concerns at the location, and prompting mechanisms, which will be effective in solving problems. This application is the most economical way in reaching fast and effective solutions. It is economical, because problems reach the top of the organization without any loss of time and information. For concerns aroused at any level of progress within the system, calling 184, or applying to the unit personally triggers the mechanism of self-control <a href="http://www.saglik.gov.tr/TR,11429/temel-amac-ve-hedefimiz.html">http://www.saglik.gov.tr/TR,11429/temel-amac-ve-hedefimiz.html</a>
Republic of Turkey Medical Devices and Drugs Databank		Republic of Turkey Medical Devices and Drugs Databank has been established <a href="https://titubb.titck.gov.tr/">https://titubb.titck.gov.tr/</a>

The Governmental Accountability Office of America finds the Medicare and Medicaid programmes extremely risky. The reason for this is the inappropriate payments that amount to 70 billion dollars in 2010. Inappropriate payments are caused by double demand frauds, waste that is caused by ineffective work and misuse (Ferilli 2013, Preface).

Health Care Fraud and Abuse Control Program (HCFAC) was created by Health Insurance Portability and Accountability Act of 1996 (HIPAA) with the partnership

of the Attorney General and Department of Health and Human Services Secretariat (Townsend 2013, viii).

In USA in the year 2011, the Department of Justice launched 1110 new criminal health fraud investigations which include 2560 potential criminals. Federal attorneys are still conducting 1873 investigations that concern 3118 potential criminals. Besides that, they have prepared 489 cases which contain 1430 criminals with criminal crimes. A total of 743 defendants were found guilty within the year regarding criminal crimes about health (Townsend 2013, 2).

*The Team That Was Created Against Health Fraud in USA:  
Health Care Fraud Prevention & Enforcement Action Team (HEAT)*

The Attorney General and Department of Health and Human Services (HHS) gives counselling regularly in a senior and staff basis towards the success of the programme's goals for the carrying out, coordination and the completion of the programme. On 20 May 2009, the Attorney General and the Secretary of Department of Health and Human Services Kathleen Sebelius announced the HEAT Health Care Fraud Prevention & Enforcement Action Team. With the announcement of the Health Care Fraud Prevention & Enforcement Action Team, the Department of Justice and the Department of Health and Human Services took responsibility and liability on cabinet basis in healthcare fraud prevention. The HEAT Health Care Fraud Prevention & Enforcement Action Team consists of:

- Senior legal enforcement representatives,
- Prosecutors,
- Judges,
- Auditors,
- Assessors,
- Staff from the Department of Justice and the Department of Health and Human Services.

The duties of the HEAT Health Care Fraud Prevention & Enforcement Action Team include the following:

- Regulating certain resources in order to guard against misuse, fraud and waste in medical programmes,
- Taking firm measures against frauds who abuse the system and cost the public millions of dollars,
- Reduction of healthcare costs and increase of healthcare quality,
- Presenting the best examples for public officers and suppliers who want to terminate waste, fraud prevention and misuse,
- Creating a partnership between the Department of Justice and the Department of Health and Human Services to reduce missing taxes and fraud (Townsend 2013, 8–9).

**Table 4.3** US figures of criminal healthcare fraud subjects in 2010

	Number of criminal subject cases	Percentage of total number of subjects (%)
Medical facilities		24.3
Medical practices	1101	
Medical centres or clinics	807	
Durable medical equipment suppliers	1275	16.2
Home health agencies	639	8.1
Other centres, clinics or facilities	598	7.6
Hospitals	357	4.5
Pharmacies	321	4.1
Nursing homes	253	3.2
Management service providers	209	2.7
Medical transportation companies	200	2.5
Other	162	2.1
Mental health centres, clinics or facilities	122	1.6
Government employees, contractors or grantees	103	1.3
Insurance companies	79	1.0
Dental clinics or practices	55	0.7
Pharmaceutical manufacturers or suppliers	38	0.5
Medical supply companies	18	0.2
Unknown affiliation		19.2
Healthcare providers		
Individuals		
Data unavailable		
Total	7848	

Source The US Government Accountability Office (GAO). Products. <http://www.gao.gov/assets/660/650341.pdf>  
 Stallone (2013)

According to the report announced by the Government Accountability Office<sup>6</sup> (GAO), the numbers and percentages of Criminal Health Care Fraud in 2010 are as follows (Stallone 2013, 17–18) (Table 4.3).

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<sup>6</sup>US Governmental Accountability Office, <http://www.gao.gov/>.

### 4.4 Measures that Need to Be Taken to Prevent Fraud in the Health Sector

The components of health care are like living organisms. The most successful organisms are those that are in a moving and changing relationship with their environment. Patients ask for new healthcare technologies and medicine that are constantly changing (Jackson 2009, 12) Fraud is a social, technological, sociological and political issue. As long as the business processes in the health sector change, fraud will shift in magnitude. Following measures can be taken in the topic of improving ethical behaviour and preventing fraud in the health sector;

- ✓ To prevent fraud in the health sector, *one must first have knowledge about the current status of fraud charts and their progress.* For this reason, an instant stream of information where fraud can be seen in operational fields of the health sector is needed. The pool of information that is created by the collection of these cases can be relayed to those concerned as education, books or websites. To create the fraud charts:

Name of the fraud	Definition of the fraud	Formation of the fraud	Participants of the fraud	The duration of the fraud	The way fraud is captured	The material and emotional consequences of the fraud	The precautions taken after the fraud
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According to the information ACFE published in its website in 2013, ten common frauds observed in the health sector are as follows:

- Billing despite no services provided,
- Inclusion in the bill despite no services,
- Falsifying the service date,
- Falsifying the service location,
- Falsifying the person that gave the service,
- Waiving deduction and contribution fees,
- Misinterpretation of the illness and its symptoms,
- Giving more services than needed,
- Bribery,
- Unnecessary use of insurance and medication (Piper 2013).

Dr. Taryn Vian of Boston University Global Health Management Department, in Table 4.4 he created, examined the types of corruption in the health sector and consequences and pioneered the creation of “fraud tree in the healthcare sector”.

**Table 4.4** Types of corruption in the health sector and consequences

Area or process	Types of corruption and problems	Indicators or Results
Construction and rehabilitation of health facilities	<ul style="list-style-type: none"> <li>• Bribes, kickbacks and political considerations influencing the contracting process</li> <li>• Contractors fail to perform and are not held accountable</li> </ul>	<ul style="list-style-type: none"> <li>• High cost, low-quality facilities and construction work</li> <li>• Location of facilities that does not correspond to need, resulting in inequities in access</li> <li>• Biased distribution of infrastructure favouring urban- and elite-focused services, high technology</li> </ul>
Purchase of equipment and supplies, including drugs	<ul style="list-style-type: none"> <li>• Bribes, kickbacks and political considerations influencing specifications and winners of bids</li> <li>• Collusion or bid rigging during procurement</li> <li>• Lack of incentives to choose low cost and high-quality suppliers</li> <li>• Unethical drug promotion</li> <li>• Suppliers fail to deliver and are not held accountable</li> </ul>	<ul style="list-style-type: none"> <li>• High cost, inappropriate or duplicative drugs and equipment</li> <li>• Inappropriate equipment located without consideration of true need</li> <li>• Substandard equipment and drugs</li> <li>• Inequities due to inadequate funds left to provide for all needs</li> </ul>
Distribution and use of drugs and supplies in service delivery	<ul style="list-style-type: none"> <li>• Theft (for personal use) or diversion (for private sector resale) of drugs/supplies at storage and distribution points</li> <li>• Sale of drugs or supplies that were supposed to be free</li> </ul>	<ul style="list-style-type: none"> <li>• Lower utilization</li> <li>• Patients do not get proper treatment</li> <li>• Patients must make informal payments to obtain drugs</li> <li>• Interruption of treatment or incomplete treatment, leading to the development of anti-microbial resistance</li> </ul>
Regulation of quality in products, services, facilities and professionals	<ul style="list-style-type: none"> <li>• Bribes to speed process or gain approval for drug registration, drug quality inspection, or certification of good manufacturing practices</li> <li>• Bribes or political considerations influence results of inspections or suppress findings</li> <li>• Biased application of sanitary regulations for restaurants, food production and cosmetics</li> <li>• Biased application of accreditation, certification or licensing procedures and standards</li> </ul>	<ul style="list-style-type: none"> <li>• Sub-therapeutic or fake drugs allowed on market</li> <li>• Marginal suppliers are allowed to continue participating in bids, getting government work</li> <li>• Increased incidence of food poisoning</li> <li>• Spread of infectious and communicable diseases</li> <li>• Poor quality facilities continue to function</li> <li>• Incompetent or fake professionals continue to practise</li> </ul>
Education of health professionals	<ul style="list-style-type: none"> <li>• Bribes to gain place in medical school or other pre-service training</li> <li>• Bribes to obtain passing grades</li> <li>• Political influence, nepotism in the selection of candidates for training opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• Incompetent professionals practising medicine or working in health professions</li> <li>• Loss of faith and freedom due to unfair system</li> </ul>
Medical research	<ul style="list-style-type: none"> <li>• Pseudo-trials funded by drug companies that are really for marketing</li> <li>• Misunderstanding of informed consent and other issues of adequate standards in developing countries</li> </ul>	<ul style="list-style-type: none"> <li>• Violation of individual rights</li> <li>• Biases and inequities in research</li> </ul>

Source Viani (2002)

✓ A team that works within the scope of the Ministry of Health, the Ministry of Finance, Public Oversight, Accounting and Auditing Standards Authority, the Financial Crime Investigation Board Administration (MASAK), the Council of Higher Education Administration (YÖK), Union of Chambers of Certified Public Accountants Turkey (TÜRMOB), Public Internal Auditors and the Revenue Administration must be established in order to create the fraud charts in the health and pharmaceutical sectors, to determine the proactive methods which are preventative against fraud in health sector and the interactive flow of information. An example of this, HEAT, is in operation in USA. The new formation that consists of members who are representative of these organizations can operate under the name “**Fraud Prevention and Education Working Group in the Health and Pharmaceutical Sector**”.

✓ Proactive measures should be taken to prevent fraud in the health sector. Financial table frauds are noticed around 18 months after they take place. For this reason, preventing it with proactive measures is of utmost importance. In the health sector around the world, unethical behaviours and the negativity that these cause in the financial tables are increasing. Financial crises and stocks losing value as a result of business misconduct reduced the trust of investors for companies. As a result, for the companies, the ever-increasing “fraud cost” emerges as a problem that needs to be solved. According to ACFE, companies lose 5 TL of their 100 TL income as fraud cost (ACFE 2016). This situation indicates that new solution proposals are due for the implementation. It is thought that placing emphasis on the following factors will reduce fraud in the health sector.

- Making new staff read and sign the ethical policies and exercises of the company when they start working in the health sector,
- Writing the ethical codes of companies which operate in the health sector specifically,
- Establishing an ethical line between companies which operate in the health sector,
- Defining accounting standards specific to the health sector,
- Defining accounting and auditing standards which are specific to the health sector,
- Defining fraud tree specific to the health sector,
- Writing the internal control procedures in the health businesses in accordance with COSO<sup>7</sup> Framework,
- Employing internal auditors that have a certificate from the Institute of Internal Auditing-Turkey<sup>8</sup> for businesses in the health sector,
- Employing fraud examining experts that are certified by Association of Certified Fraud Examiners in businesses in the health sector,
- Spot inspections in businesses in the health sector,
- Continuous education about ethics and fraud prevention in businesses in the health sector,
- Independent and internal auditors conducting risk-based auditing,

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<sup>7</sup>Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control—Integrated Framework Executive Summary, [https://na.theiia.org/standards-guidance/topics/Documents/Executive\\_Summary.pdf](https://na.theiia.org/standards-guidance/topics/Documents/Executive_Summary.pdf).

<sup>8</sup><https://na.theiia.org/Pages/IIAHome.aspx>.



- Appointing the Audit Committee members from outside of the company; these auditors being experts on financial and non-financial chart auditing, that these auditors having experience with the health sector.

✓ *The main purpose of audit of health services is to control if effective, active and high-quality health services that include whether systematic health services procedures are carried out, or not.* The costs need to be reduced by removing affairs that include misuse, fraud, medical errors and services that do not add any value from the business process. For this reason, by auditing the health services the following can happen:

- The review of the level of conformity of health services from an internal perspective to the regulations,
- The review of the effect of health services on the brand recognition and productivity of the healthcare provider,
- The comparison of health services with the competition (Min 2014, 57).

✓ *The financial charts of companies operating in the health sector that are prepared in accordance with International Accounting Standards being audited by Independent Auditors in accordance with International Audit Standards and the reveal of the financial charts to shareholders via press, increases company performance and recognition.* In companies without economical problems, fraud is observed less. The standard the independent auditor will use during audit about fraud in companies in the health sector is TSA 240. TSA 240<sup>9</sup> is the Standard of Responsibility of the Auditor against Fraud in Independence Audit of Financial Charts. According to this standard, the auditor keeps his professional scepticism during audit with the knowledge of the possibility of a significant mistake caused by fraud, regardless of his past experience about the righteousness and honesty of the administration and those who are responsible for senior management in a way that also includes TSA 200.<sup>10</sup>

✓ Another way of fraud protection in health businesses is the Fraud Free Company Model. This model suggests the implantation of fraud prevention methods in all processes of the company. This is a process that needs to be performed by Certified Fraud Examiners<sup>11</sup> (Çalıyurt 2012, 12).

✓ *It increases the trust of the shareholders for the companies which operate in the Health Sector to present an Annual Fraud Prevention Report.* Çalıyurt (2012) in her research suggests for the reveal of fraud prevention activities of all companies that are both publicly held or not with an “Annual Fraud Prevention Report”. Çalıyurt, who proposes that the Annual Fraud Prevention Reports to be categorized with the

<sup>9</sup>TSA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements, [http://kgk.gov.tr/Portalv2Uploads/files/PDF%20linkleri/standartlar%20ve%20ilke%20kararlar%C4%B1/DENET%C4%BOM%20STANDARTLARI/BDS\\_240.pdf](http://kgk.gov.tr/Portalv2Uploads/files/PDF%20linkleri/standartlar%20ve%20ilke%20kararlar%C4%B1/DENET%C4%BOM%20STANDARTLARI/BDS_240.pdf).

<sup>10</sup>TSA 200, Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing.

<sup>11</sup><http://www.acfe.com/become-cfe-qualifications.aspx>.

classification system, points out that investors investing without examining the category in which these reports are is a risk, especially in developing and underdeveloped countries.

✓ *It increases the respectability and financial performances of the companies which operate in the health sectors to publish non-financial reports besides financial reports. Companies who report according to Global Reporting Initiative (GRI), which is the most widely used of non-financial reporting systems, report their internal anti-fraud works that are in accordance with the GRI standards.* GRI is a non-profit organization that was founded in 1997 to aid the popularization of sustainability reporting to create a sustainable global economy. The reporting standards published by GRI, which has its headquarters in Amsterdam, are de facto global sustainability reporting standards that are followed by thousands of organizations all over the world (<http://www.kurumsalsurdurulebilirlik.com/tr-tr/hakimizda.aspx>). For example; they write down how many incidents regarding fraud they reviewed during the year in the company in the GRI report (<https://www.globalreporting.org/resource/library/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf>). Abdi Ibrahim Company which operates in the pharmaceutical sector and is a member of the GRI states their approach towards fraud as follows ([http://www.abdiibrahim.com.tr/download/Abdi\\_Ibrahim\\_GRI.pdf](http://www.abdiibrahim.com.tr/download/Abdi_Ibrahim_GRI.pdf)):

The sensitivity that Abdi Ibrahim shows in terms of product responsibility was the defining factor in the company earning a respectable reputation in the public opinion. As stated in the Ethical Behaviour Principles of the company, all Research and Development (R&D) and clinical research are conducted in accordance with National Legislation as well as International Regulations. The company which is focused on reaching a high product quality, reduced volunteer use in its R&D work in light of recent developments in medical ethic, and completely phased out of animal experiments. Abdi Ibrahim, which observes the use process of their products closely because of medical ethic, keeps tabs on the unwanted effects of the medicine and feedback regarding medicine quality and informs the concerned authorities if need be. Besides that, all employees of the company are obligated to report any just or unjust complaint towards the safety and quality of its products or products that are suspected to be fraudulent that they received from customers, doctors, pharmacies, first users by telephone, fax, e-mail, websites, meetings or other channels of communications to the executives in 24 h.

✓ *Another substantial factor in preventing fraud for the companies is participating the training activities and becoming a member of the United Nations Global Compact (UNGC) platform, the effectiveness of which is being continuously increasing; a platform where the companies will enhance their corporate governance practices and which will assist them with recognisability in this respect. This platform has studies considering fraud prevention.* Those companies willing to progress in corporate governance would become a member of United Nations Global Compact. UNGC supplies support to companies regarding “fight against fraud”,<sup>12</sup> which is one of its ten rules. UNGC member Turkish firms in health and pharmaceutical sector are listed

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<sup>12</sup><https://www.unglobalcompact.org/what-is-gc/mission/principles/principle-10>.

below. These companies report about the realization of fraud prevention rule which is among UNGC<sup>13</sup> rules (Table 4.5).

The most significant factor in fraud prevention in health sector is continuously providing integrated training regarding ethics, accountability, corporate governance, fraud prevention and social responsibility. We are witnessing that many national, company-based, and non-governmental organizations-based anti-corruption laws and practices are being tried to be installed into our lives. We have to keep in mind this question: Would Enrol Scandal take place if laws and rules had been this much effective back then? Against the rise of corruption in health sector, how many of the faculties that educate managers for the health sector have these courses in their curricula? In the case of Turkey, this number is next to zero. How could a manager raise awareness regarding a topic he/she is unfamiliar with, and did not get any training about? Such a thing is impossible. Çalyurt in her study (2007), with the help of questionnaires sent to faculties of management, measured the level of ethics training in accounting education. According to the results obtained, ethics education in accounting is not satisfactory. The academicians taking part in the survey and responded the questionnaires stated that they would have lectured more on ethics in case they had ethics training. Academics who participated in and answered the survey stated that if they had ethics education they would have taught more about ethics on their own courses. Çalyurt and Crowther (2006) in their other research stated that 50% of those who teach accounting educate about ethics but only 7.1% of lecturers took “fraud prevention” courses during their own education. Alongside this, Şahin and others laid out important results with their survey to the staff of the Ministry of Health. This research happened by e-mailing this survey that defines the scope of frauds such as bribery, embezzlement, patronage and corruption to 4075 Ministry of Health staff. Public health sector staff in Turkey, while interpreting the statements about fraud as unacceptable, they define the frequency of the said frauds happening quite high. Furthermore, the potential of executives of health institutions getting gradually involved in fraud is higher than other personnel, and the most important reason of fraud is stated as bad management and auditing, political patronage and the responsibility of accountability not being established.

Considering the fact that executives of businesses in health sector are graduates of faculties that give education about management sciences and keeping in mind the studies of Şahin et al. (2009, 101), we can grasp the importance of “fraud prevention in the health sector” being taken seriously and becoming mandatory rather easily. Reinforcement of ethical behaviour of health sector personnel and interest groups should prevent fraud. Ways of creating a more transparent, accountable and institutionalized health sector business come from following the developments in management science and applying them.

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<sup>13</sup>UNGC, United Nations Global Compact, <https://www.unglobalcompact.org/what-is-gc/our-work/governance/anti-corruption>.

**Table 4.5** UNGC participant Turkish firms in health and pharmaceutical sector & biotechnology

Name	Type	Sector	Joined on
Bilim Pharmaceuticals	Company	Pharmaceuticals & Biotechnology	2010-04-30
PharmaVision Sanayi ve Ticaret A.S.	Company	Pharmaceuticals & Biotechnology	2010-05-24
KEYMEN ILAC SANAYI VE TICARET A.S.	Small or Medium-sized Enterprise	Pharmaceuticals & Biotechnology	2010-05-25
Adeka Ilac San. ve Tic. A.S.	Company	Pharmaceuticals & Biotechnology	2010-05-26
Kansuk Laboratuari Sanayi ve Ticaret A.S.	Small or Medium-sized Enterprise	Pharmaceuticals & Biotechnology	2010-05-26
Mustafa Nevzat Ilac Sanayii A.S. (MN Pharmaceuticals)	Company	Pharmaceuticals & Biotechnology	2010-05-26
Santa Farma	Company	Pharmaceuticals & Biotechnology	2010-05-26
Yılbak Ticaret A.S.	Small or Medium-sized Enterprise	Pharmaceuticals & Biotechnology	2010-06-03
Genesis Ilac ve Saglik Urunleri A.S.	Small or Medium-sized Enterprise	Pharmaceuticals & Biotechnology	2010-06-29
Ali Raif Ilac Sanayii A.S.	Company	Pharmaceuticals & Biotechnology	2010-07-15
EDAK Pharmacists Production, Supply and Distribution Cooperative	Company	Pharmaceuticals & Biotechnology	2010-08-04
Abdi Ibrahim Ilac Sanayi ve Tic. AS	Company	Pharmaceuticals & Biotechnology	2010-09-16
Teva Türkiye	Small or Medium-sized Enterprise	Pharmaceuticals & Biotechnology	2012-02-02

Source United Nations Global Compact. Who we are. Our participants. [https://www.unglobalcompact.org/what-is-gc/participants/search?utf8=%E2%9C%93&search%5Bkeywords%5D=&search%5Bcountries%5D%5B%5D=202&search%5Bsectors%5D%5B%5D=10&search%5Bper\\_page%5D=50&search%5Bsort\\_field%5D=&search%5Bsort\\_direction%5D=asc](https://www.unglobalcompact.org/what-is-gc/participants/search?utf8=%E2%9C%93&search%5Bkeywords%5D=&search%5Bcountries%5D%5B%5D=202&search%5Bsectors%5D%5B%5D=10&search%5Bper_page%5D=50&search%5Bsort_field%5D=&search%5Bsort_direction%5D=asc). Accessed on 17 Feb 2017

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# Chapter 5

## The Emerging Role of Managerial and Accounting Ethics for Creating a Corporate Ethical Structure in Organizations



Neşe Çoban Çelikdemir and Melisa Erdilek Karabay

### 5.1 Introduction

Business ethics as a requirement for corporations is no longer indispensable. While the competition is today more severe, the ethical behaviors of enterprises began to influence their operations in the long term. The past half-century was assessed with the performance of business not only through moral but also within economic and social contributions. Recent scandals played a critical stage for emerging ethical conduct. Scandals emerged from the misuse of ethics have drew attention to accounting ethics. In this context, the field of ethics is directly related to the concept of social responsibility since the management has to harmonize much more the responsibilities toward the society it exists and its shareholders.

Among scholars and practitioners, there have been many attempts to establish a better understanding of CSR with conceptualizations in the literature. However, there is a lack of consensus on what the concept explains, the reason why it should be developed, and what its roles are for achieving organizational performance (Obalola 2010, 38). Regarding the ethics, corporations need to be informed about any unethical behavior to comply with ethical rules that would damage the reputation as the cost may be very high. Ethical principles and standards, along with installing various obligations to managers, also guide them in decision-making processes. Today, the establishment of ethical codes has gained significant importance.

Business ethics appears as an indispensable discipline for achieving sustainability. Scholars argue whether the business system can be reinforced in terms of efficient practices of managerial ethics of enterprises. This is linked to an organizational behavior of a corporation. However, the literature represents inadequate number of researches combining the dimensions of ethical behavior within managerial and accounting perspectives.

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To fulfill this gap, this study aims to explain the emerging roles of business ethics among organizations within the framework of managerial and accounting ethics. The main purpose of this study is to draw attention to the importance of managerial and accounting ethics in relation to social responsibility of corporations. In this context, the study explains the ethics in a comprehensive conceptual framework and discusses business ethics in terms of CSR. Future recommendations for the improvement of ethical environment and the institutionalization of ethical structure are also highlighted in the final section of the study.

## 5.2 Conceptual Framework of Business Ethics

The last decade has seen a significant increase in business ethics research and literature. This is in fact the result of the growing importance of business ethics in the international arena (Hitt 1990, 98; Koh and Boo 2001, 309). As in the formation of the behavior of a person or an organization, the cultural items of society is influential in the ethical understanding since many factors that influence ethical values vary from person to person like context of social cultures vary from society to society (Vural and Coşkun 2011, 68). Business ethics became essential for conducting any type of business in the global marketplace (Aydinlik and Dönmez 2007, 151). Principles of business ethics are not necessarily written; nevertheless, these principles can make it easier to transfer and allow learning for the creation of standards (Vural and Coşkun 2011, 70). Firms develop their ethical culture with a view to enhance their point of view in business ethics inside and outside the organization. Ethical values are, therefore, important in determining attitudes to be adopted in the face of moral issues and may also be useful in the management of the different business applications (Aydinlik and Dönmez 2007, 151).

Although there is no precise definition of business ethics in the literature yet, there is a common expression that companies have to establish a balance between their social responsibilities and welfare not conflicting with their own economic interests so that they will be able to make choices based on the principles and beliefs (Yılmaz and Çevik 2011, 166). As individuals, managers, and employees in an organization have responsibilities, it can be stated that a corporation can be described as an artificial person that have artificial responsibilities.

The first step toward understanding the social responsibility of business is to understand the way it implies (Friedman 1970, 1). In general, profession of business ethics is related to the “moral principles and standards that guide behavior in the world of business” (Vural and Coşkun 2011, 69). Despite the growing literature, the impact of ethical and unethical behavior in business provides a limited amount of research (Bommer et al. 1987, 265). There are numerous researches in the field of business ethics as well as ethical climate (Victor and Cullen 1987; Wimbush and Shephard 1994; Schminke et al. 2005; Padron et al. 2008; Valentine and Fleischman 2008) and its aspects related to organizational behavior (Zahra and LaTour 1987; Zenisek 1979; Marin et al. 2009). To ensure a strong ethical culture, corporations generally focus

on high public expectations for socially responsible and ethical behaviors (Luthar and Karri 2005, 353).

Traditionally, there have been two views on the role of ethics in business. The first view is that the corporate executives' social responsibility (Gariga and Mele 2004, 53) is to "maximize the shareholder's value". This is often related to the managerial ethics. The second is that "ethics pays" (which is acting in a socially responsible way toward shareholder) will automatically increase shareholder wealth (Verhezen 2005; Azmi 2006, 2). Ethics has potential consequences on internal environmental factors like customers, employees, competitors, and the general public (Koh and Boo 2001, 309).

Researches indicated that moral conduct in organizations is indispensable for good business (Conroy and Emerson 2004; Giacalone and Jurkiewicz 2003; Joyner and Payne 2002). The amount of research that is related to the role of ethics within the functions of business is still limited. In this paper, the ethics is discussed in terms of its managerial and accounting sphere as well as its corporate social view, since ethics with many aspects has been in the agenda of many corporations, academic sphere, and the practitioners.

### ***5.2.1 Relation Between Corporate Social Responsibility and Ethics***

Business as a creation of society is required to perform certain duties and comply with certain rules and regulations (Obalola 2010, 38). As stated in the various studies (Carroll 1999; Valor 2005; Waddock 2001; Carroll 1991; Donaldson and Preston 1995), business practices have been more and more susceptible to wide criticism, concerning ethics and social responsibility (Obalola 2010, 68). Therefore, there is an increasing call for companies to be more ethical and socially responsible in their operations. CSR has been one of the most debated management issues, with both academics and practitioners expressing the rationale behind why corporations should adopt ethical and socially responsible behavior. However, there is a lack of consensus on CSR in terms of achieving organizational effectiveness or performance and many other issues bordering on the concept (Obalola 2010, 38).

Corporate social responsibility is defined as the agreements on behalf of ongoing practices of business acting ethical through, employees, society and the environment to contribute to economic development (Saylı and Uğurlu 2007, 85).

Often referred to the effects of social responsibility in business, corporate social responsibility can be expressed broadly as: "*The corporation's ethical and responsible act through partners (business aiming profit, government agencies or non-governmental organizations), representing the direction to make decisions, and the application of ethics covering all the factors (endogenous, exogenous and organizational) of the organization*".

There is an increasing amount of discussion for companies to be more ethical and socially responsible in their operations (Obalola 2010, 68; Carroll 1999; Valor 2005;

Waddock 2001; Carroll 1991; Donaldson and Preston 1995) since corporate scandals focused much more on the firms' actions and the reconsideration of the process where strategic decisions are taken (Hitt and Collins 2007, 354). Corporations, as the leading models of a society, are required to perform certain duties and comply with certain ethical rules and regulations (Obalola 2010, 38). For example, the former world's seventh largest company Enron, at 2001, declared bankruptcy. Independent of Enron, the case of Arthur Anderson's audit and business consulting under the control of the most powerful institutions shook the confidence of the community (Akatay 2008, 103–104; Saylı and Uğurlu 2007, 89). All these developments in business sphere started the discussion of role of ethical practices and the sustainability of a corporation.

Today, there is a growing belief that corporations have become social actors responsible for the ethical or unethical behaviors of their employees (Victor and Cullen 1988, 101). Yet, corporate social responsibility practices are planned, implemented, and evaluated at the level of the management team appointed by government units. Demonstrating socially responsible behaviors ethical in the short term provides concessions to defeat difficulties to corporations, although providing long-term benefits (Akatay 2008, 98). CSR is therefore can be defined as a driver for:

- Pursuing economic goals (economic responsibility) in the most acceptable and agreeable ways (ethical and legal responsibility), and
- Giving something back to society (philanthropic responsibility) (Carroll 1991, 41).

Choo and Tan (2012) define the corporate scandal as “*a scandal involving allegations of unethical behavior on the part of a company*”. It often involves unethical behavior in accounting, that is mostly an accounting fraud. Besides, less functioning management and managers, corruption such as bribery, nepotism, looting generating an interest are likely outcomes of an unethical culture. Other contributing factors like organizational, political, legal, and financial reasons also have great importance and subject to debate (Çevikbaş 2006, 266). The importance of the concept of corporate social responsibility is fostered by increasing anxiety of execution of inappropriate legal, moral standards during the commercial activities as well as by the fact that the evolving managerial ideas and practices that are effective management philosophy (Akatay 2008, 103). The following sections will explain the ethics of managerial dimension in a comprehensive perspective.

### 5.2.2 *Managerial Ethics in Corporations*

The issue of ethics has become more pertinent as globalization led to increased business competition that captured attention over ethics (Singh et al. 2005, 91). Following with the negative aspects of corruption after 1990s, unethical business behavior and the conduction of management with low ethical standards have been main subjects to ethical behavior (Bucar et al. 2003, 262). Management, as a major field of business, appears not just a case of technical and political, but also capable

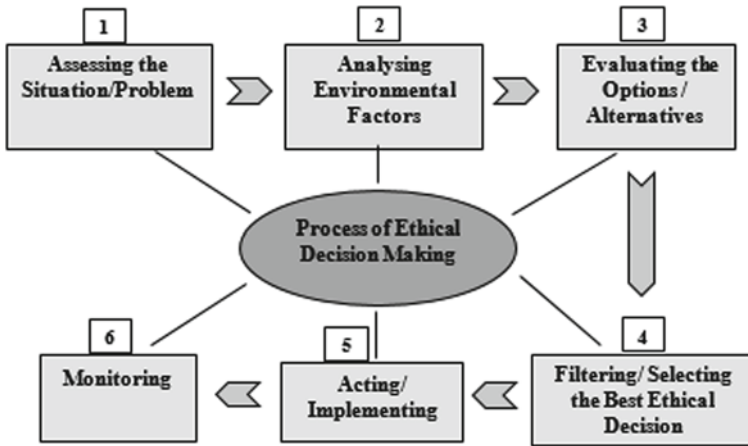
of functioning as ethical (Çevikbaş 2006, 285). Managerial ethics has been among one of the debated topics in business organizations today (Stead et al. 1990, 233).

Similar to Enron case, other scandals like “WorldCom” and “Parmalat” have been other business cases in terms of responsibilities against shareholders. All these and other cases of corruption and governance practices of corporate social responsibility emerged the role of management (Akatay 2008, 103–104; Saylı and Uğurlu 2007, 89).

In today’s organizational dimension, policies of executive management have considerable influence on organizational ethics (Koh and Boo 2001, 320). Since managers are the role models in the organizations (Stead et al. 1990, 238), management team needs to provide the establishment of ethical conduct by preserving the benefit of everyone to implement the decisions and policies, meeting the organizational and individual needs and the benefits of the parties considering the important responsibilities (Aydın 2002, 47). The concept of managerial ethics, also referred to as an expression of correct action and procedures, is necessary to achieve the principles and standards (Çevikbaş 2006, 269). In case of non-ethical management, the cases of corruption, nepotism, conflict of interest are possible to see many different types of distortion (Yılmaz and Çevik 2011, 168). When we evaluate the managerial ethics in positive perspective, it appears as the reflection of the general positive aspects to organizational objectives and organizational culture while the negative view refers to the status gains of employees to ensure the individual standard tasks (Kılavuz 2002, 258–259). Giving ethics and social responsibility a prominent role in the strategic management process can enhance these achievements like efficient use of corporate resources to achieve organizational goals (Obalola 2010, 63).

The literature comprises various researches in regard to CSR and ethics. Quazi and O’Brien (2000), in their study, examined the corporate social responsibility in two-dimensional model: narrow to wider perspective and cost to benefit driven perspective. Jin and Drozdenko (2010) investigated the relationships among organizational values, ethics, corporate social responsibility, and organizational outcome. The findings indicated that organizations with core values reported a higher level of social responsibility than organizations with mechanistic values. They also found that as well as perceived ethical attitudes and social responsibility significantly associated with organizational performance outcome measures. Jones and Gautschi (1988), in their study, investigated the attitudes of future business executives toward issues of social responsibility and business ethics. Results showed that women tend to show more strong feelings regarding such issues.

Despite many researches, it is important that managerial ethics is not only limited to CSR. Managing ethical behavior is a critical organizational variable that reveals as a social issue for organizations (Stead et al. 1990, 234). Ethical behaviors of managers are related by a complex interaction between the manager’s personal value system and that of upper management, that result in a manager’s ethical decisions being influenced by considerations other than their personal value systems (Bucar et al. 2003, 268). Within management dimension, ethical issues may appear in any level of the decision-making process (Jones and Pollitt 1998, 703). As illustrated in Fig. 5.1, ethical decision making is a process where managerial needs are taken into account in compliance with business ethics of a corporation.



**Fig. 5.1** Ethical decision making

A firm's ethical climate is composed of ethical values and the moral behaviors of overall employees (Schwepker 2001, 39). However, there is a fact that managers cannot expect the ethical behavior from employees if they do not behave so. The consistency between moral philosophy and behavior appears as an essential factor (Stead et al. 1990, 238). The literature shows that ethical philosophies will have little impact on employees' ethical behavior unless they are supported by managerial behaviors (Stead et al. 1990, 235–236). This shows that ethical climate positively influences managers' ethical decision-making intentions (Brown and Trevino 2006, 601).

Another critical point is that managers' ethical decisions is associated not just to the legal consequences, but also to the desire to comply with the moral force within the legal framework. Various associations today began to establish formal codes of ethics (Bommer et al. 1987, 269–270). They play critical role when codes become an active part of an employee's working knowledge since it affects ethical decision making (Schwepker 2001, 40). By implementing codes of ethics, management can create an ethical climate that positively influences ethical behavior in the organization. This is mostly enhanced by rewarding the ethical and punishing unethical behaviors (Schwepker 2001, 41).

Another organizational factor that influences ethical behavior is the firm's reinforcement system. Research supports the evidence that if ethical behavior is desired, the performance measurement, appraisal, and reward systems must be established in an organization (Stead et al. 1990, 236). Ethical decision making, in this sense, can indirectly contribute to improved firm performance (Hitt and Collins 2007, 355). Some corporations make apparently unethical decisions which their managers believe to be in shareholders' interests (Jones and Pollitt 1998, 703). For example, while setting managerial objectives it is critical to consider ethical concerns relating to the choice of pursuing various directions. Criticisms of normative models (that explains

**Fig. 5.2** Ethical responsibilities



what should be business ethics) led to the development of positive models (that describes what actually occurs in the organization) (Loe et al. 2000, 185).

So, it can be stated that a culture that embraces stakeholders and their moral values can be the inputs of company's strategic decision-making process. This will play a significant role in reaching such opportunities that can produce growth and enhanced profitability.

Creating an ethical culture is often affected by ethical considerations of a manager's personal values (Bommer et al. 1987, 274–275). Besides, as illustrated in Fig. 5.2, the managers have various responsibilities contributed with endogenous factors (employees, shareholders, investors, national and international community, suppliers, competitors, government and local authorities, professional associations, and non-governmental organizations) and the internal factors like staff, structure, strategy, and the shareholders. Managers and shareholders have direct responsibility (to conduct the business in accordance with their desires) to their employers. One responsibility is also to generate as much money as possible embodied in law and those embodied in ethical custom. In either case, executives appear as role models to lead and behave in terms of ethical sense (Friedman 1970, 1).

### 5.2.3 Accounting Ethics

Regarding the link between CSR and ethics accounting, ethics also plays a critical role in business. Accounting, in general, refers to the reliable data collection, recording, classification, summarizing them in a meaningful way, and presentation in terms execution of actions for the purposes of the business-related interest groups (Daştan 2009, 285). When considered, ethical values of business exist on the basis of all legal regulations and practices, related to the accounting profession. Accounting profession is, therefore, highly concerned with reputation and trust in the profession. In order to execute this profession as much as reputable, essentially, the ethical standards of the profession must entirely be complied (Sanlı 2012, 3). Regarding

the general implementation of the accounting ethics and standards, International Accounting Business Standards is dealt with the concepts listed below:

- Honesty,
- Objectivity,
- Professional competence and due care,
- Privacy and confidentiality, and
- Professional conduct.

The effect of any practice unethical in accounting profession brings out the effect of spread to the whole society. For example, such unethical behaviors such as showing off unreliable data from the financial statements and tax evasion will spread to the whole community (Kutlu 2008, 148). A professional accountant is responsible for the production of accounting and financial reports, providing information of great importance not only in terms of the distribution of economic resources to the parties concerned, but also to entire society. A professional accountant not bringing this responsibility to the society, generating information for the interests of certain individuals or groups instead, will lead to unfair use of resources and more importantly will result in the aggrievance of social environment (Kısakürek and Alpan 2010, 216–217).

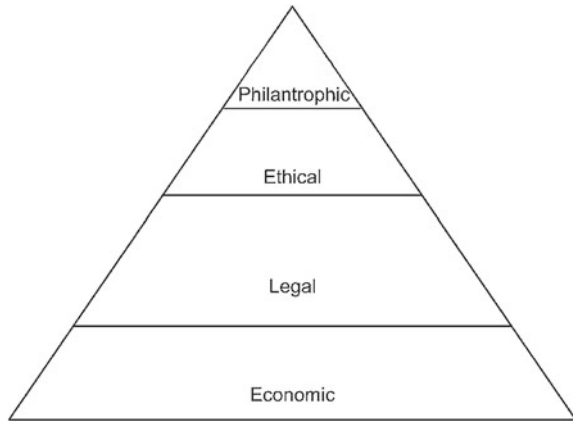
Another fact is that, because accounting is perceived as a bridge between the corporations and interest groups, information provided by accounting is used by a large segment of groups which affects their decisions directly. In this respect, ethical decisions are an important issue not only in managerial function but also in accounting. On the other hand, recent accounting scandals reveal that inadequate care is implemented within relevant laws, professional ethics, and social values (Güney and Çınar 2012, 92). Corporate scandals especially have shown the emerging interest of public trust and increased emphasis on accounting ethics (Kutluk and Ersoy 2011, 425). As Kısakürek and Alpan (2010) define, professional accounting ethics, which focus on the usefulness it provides for the users of financial statements, is associated with the:

- acting in accordance with law professionals,
- carrying out their professional activities loyal to social values,
- taking into account reliable, relevant, understandable, accurate, consistent presentation of the information society and customers, the community,
- conducting effective professional associations and relationships with colleagues, and
- conducting the set of rules that must be followed.

When the responsibility dimension is considered, two basic qualifications are required for the members of profession like distinguishing right from wrong (referred to ethical side) and having confidence in knowledge (profession side) (Kutluk and Ersoy 2011, 436–437). Therefore, it is a prerequisite for accounting professionals to have the knowledge and skills complied with the ethical standards that will bear the responsibility.



**Fig. 5.3** A Hierarchy of CSR (Adapted from Carroll 1991)



### 5.3 Growing Importance of CSR Practices: Effects on Ethical Behaviors of Corporations

Within all the statements above, even contrasts with voluntary basis in social responsibility, we can say that the concept of corporate social responsibility agenda, especially for-profit organizations, occurs on a non-voluntary perspective. Nevertheless, many institutions in the past began to perceive CSR on issues crucial after tended to social reactions from the community (Vural and Coşkun 2011, 79). According to our view, CSR is much more than a field of corporate issues. It involves the regaining the public's trust, effective management within the framework of investor expectations, providing accuracy and integrity of financial reporting, honesty and fairness in wages (Sayılı and Uğurlu 2007, 89). It has also gone so far from establishment of the role of ethics. Sustainability, corporate philanthropy, and corporate ethical standards are the issues at the very heart of the debate right now. These are the key principles of the corporate social responsibility debate and the key principle for a company striving to make CSR that lasting purpose.

As Birch (2004) states, the company has got to improve in response to a changing world, while at the same time preserving (its) basic values and purpose (Birch 2004, 28). Carroll (1999) draws upon the responsibilities in his four faces of citizenship: ethical, legal, economic, and discretionary responsibilities. *Discretionary responsibilities/strategic* is focused on the following three primary stakeholders: employees, communities, and customers (Hemphil 2004, 348).

Carroll (1991) developed the notion of multiple corporate social responsibilities in a pyramid construct (Fig. 5.3). In this pyramid, economic responsibility is the basic foundation. Corporations meet their discretionary responsibilities by engaging in activities such as the provision of a day care center for working mothers or philanthropic contributions (Maignan and Ferel 2001, 39). Philanthropic responsibilities describe the corporate contributions, areas related to education, community involvement, and volunteerism (Pinkston and Carroll 1994, 160). According to Windsor

(2001, 225), each of these responsibilities comprises a basic component of the total social responsibility of a business firm in a sense that; economic and legal responsibilities are the ones socially required; ethical responsibility is socially expected, while philanthropy is also socially desired.

Today, in most of the departments or units for the management we can observe that corporate social responsibility is created, generated, and also represented at the level of the board of directors or departments (Akatay 2008, 106). Change of views on the conceptual and managerial corporate social responsibility is one of the factors affecting corporations giving importance to the subject as they provide significant gains. Managerial decisions will match more closely to the humanistic, religious, cultural, and societal values of society at large only when these values are made part of the job environment (Bommer et al. 1987, 268).

Regarding the literature revealed up till now, it can be stated that conducting business could be regarded as being ethical and operating within the written and unwritten law, often related to philanthropic giving in a society. Therefore, it may be expected of business to conduct its activities (economic responsibility) in the most acceptable and agreeable ways (Obalola 2010, 38).

## 5.4 Conclusion and Further Recommendations

Following recent ethics scandals in business, organizations began questioning the ethical standards. In a post-Enron case, the need for building moral values through ethical leadership in organizations highlighted that a comprehensive focus is required on managerial ethics. In this context, the main actors appear to be the management or executive business management in the understanding of corporate social responsibility, reflecting changes. A majority of the studies revealed that ethical codes help to increase the general level of awareness among ethical issues.

Another resolution of enhancing a better implementation of ethics may be the “Ethics Programs” that will create a strong ethical climate. It will also eliminate the need for more direct, elaborate, and costly forms of control and monitoring. Companies that engage in a set of managerial ethics or guidelines have the opportunity to create a clear path for managers to reference during tough decision-making scenarios.

If sustainable business is an important part of the company’s activities, then development of ethics committee will support the development, management, and monitoring of sustainable business practices. Finally, the understanding of the ethics more than the philosophy of being socially responsible may lead to companies to becoming better corporate citizens. Managerial ethics describes the moral guidance a supervisor provides his employees. Accounting ethics is, by and large, a field of applied ethics and is part of business ethics. Similar to other professional disciplines, understanding ethics is very important in the accounting field. A variety of accounting organizations, today, also have adopted codes of ethics.

In this study, the emerging roles of business ethics among organizations within the framework of managerial and accounting ethics are explained. The main purpose

of this study is to draw attention to the importance of managerial and accounting ethics in relation to social responsibility of corporations. The rationale behind this study lies on the fact that ethics in managerial and accounting has become one of the most important, yet most misunderstood, concerns in the world of business today.

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# Chapter 6

## Analysing the Effects of Unethical Culture and Organizational Commitment on Employees' and Managers' Unethical Behaviours: Evidence from Turkish Insurance Industry



Melisa Erdilek Karabay, Meral Elçi and Özgür Akpınar

### 6.1 Introduction

Global corporations have already recognized the responsibilities and make a serious effort to fulfil their ethical responsibilities while trying to follow their ethical codes as a source of competitive advantage. Since ethics has become an organizational priority, ethical culture occupies a predominant place in the management of a company. The efforts to build a powerful ethical organization with ethical employees and managers are vital for the reputation, growth, and financial success of any company. Therefore, employees' organizational commitment to their company is shaped by the existing ethical culture in the organization. In this respect, ethical culture in corporations has become increasingly essential by the rise of issues in business ethics such as fair competition, legal protection and rights, and social responsibilities. These concepts often have potential consequences on various actors in business including customers, employees, competitors, and the society (Koh and Boo 2001, 309). Therefore, organizations have to figure out how to establish an ethical culture in the organization, making ethics a priority.

One of the popular organizational strategies for establishing the ethical culture is to provide and maintain happy employees. Organizational commitment, in this regard, continues to appeal researchers due to its positive effects on employees. Organizations, which have comprehension of what causes unethical behaviour of employees, are more prone to foresee and prevent from the pervasion. Recent cases,

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like Enron and WorldCom, make the issue of ethical culture to be investigated under many circumstances. Ethical issues in the financial service industry reveal critical effects on everyone because even if an individual is not an employee, she or he inevitably becomes a consumer of the services (Federwisch 2006). Nevertheless, despite the growing interest in business ethics, the factors which affect the unethical behaviours of employees have been studied by few researchers yet. The lack of research is also true with regard to researches conducted in financial sector.

To fill the gap in the given literature, the study aims to examine the interaction between organizational commitment, unethical culture, and the unethical behaviour of employees and managers working in the insurance industry.

The paper is organized as follows. The theoretical foundation and the development of research hypotheses are presented in the first section. The evaluation of importance of ethical culture and ethical behaviour in insurance organizations is presented in the next section. In the third section, the research method carried out in this study is discussed. Finally, in the fourth section, the findings and the conclusions are presented.

## 6.2 Literature Review and Development of Hypothesis

Fostered by globalization, companies today face a variety of changes and challenges that have a significant impact on organizational dynamics and performance. Today, implementing decisions ethically has gained a critical importance in corporations. Ethics as a concept derives from the Greek word “ethos” which means character or custom. This definition is essential for sustaining the effective leadership in organizations as it provides moral integrity and consistent values in service to the society (Sims 1992). The society, today, requires the harmonization of ethical culture to corporations, as more individuals and groups involved are getting environmentally and socially responsible. They need to be accountable and transparent, inclusive, ethical, more equitable, and sustainable (Birch 2004).

Therefore, ethical culture requires a special notice compared to before since the effects of unethical culture may damage the long-term reputation of many corporations. This is particularly prospective for service sectors. Despite the fact that ethical issues examined in services are limited, researchers argue that especially some specific ethical issues in the service sector are serious. Pressures of increasing economy and some characteristics of service industry, like abstractness and inextricability which can cause the potential for ethical misconduct, may be partly its reason (Diacon and Ennew 1996b).

While establishing an ethical culture, corporations are expected to fulfil ethical responsibilities, in addition to economic and legal responsibilities. As Carroll (2000) suggests, ethical responsibilities cover a range of norms, standards, or expectations of behaviour concerning stakeholders’ moral rights or expectations. When considered at the corporate level, much can be understood from understanding the association, if any, between a firm’s ethical culture and its performance. On an individual level,

work-related factors such as job satisfaction, stress, motivation, commitment, or job performance can have a significant effect on organizations (Koh and Boo 2001). Consequently, companies “must be responsible for the moral climate of the workforce, rather than expect all of the employees to ethically monitor themselves” (Clark and Leonard 1998). The less ethical the culture, the more unethical cases will appear in an organization.

Top management appears as the main actor in establishing the ethical culture (Koh and Boo 2001). Executive sets the components of organizational culture for employees and the components served as a referent group to them. Therefore, as the literature reveals, a moral conflict will occur in any inconsistency between top management’s perceptions and the ethical attitudes of employees (Dozier and Miceli 1985; Koh and Boo 2001). Despite the fact that executives claim they maintain high ethical standards, this is not the case. Employees often have bad attitudes when there is discrepancy between top managers’ sayings and behaviours. So, it seems that working in organizations where managers do not take notice of their own ethical rules is immensely discomfort. In this sense, it is important to underline that a positive ethical culture should be established within the organization, if strong top management support for ethical behaviour can be perceived by employees. In the organization, this will lead to a strong collaboration between career success and ethical behaviour and a higher level of job satisfaction and a higher job performance (Koh and Boo 2001).

In establishing the ethical culture, leadership plays a particular role. How the leader reacts to the rivalry is a baseline for developing ethical or unethical culture. Corporate leadership, therefore, should ensure that marginal decisions are taken in such a way not to harm the reputation of the company and stakeholders. How leader can effect ethical behaviour within an organization has been shown in the Salomon and Enron cases (Balch and Armstrong 2010). In this sense, the image of the business leader will affect how others choose to deal with the company (Georgescu 2012; Sims and Brinkmann 2002).

The determinants of unethical behaviour have been proposed to bring to light by a number of researchers for the last decade (Brass et al. 1998; Ferrell and Fraedrich 1990; Buckley et al. 2001; Shi et al. 2007; Ferrell and Ferrell 1982; Tenbrunsel and Messick 2004) where some studies were concerned with the factors that investigate ethical decision-making (Bommer et al. 1987; Hegarty and Sims 1978) and ethical behaviour. However, the behavioural dimension appears to be the least researched topic area addressing the influence of ethical behaviour of employees (Cassell et al. 1997).

Adam and Moore (2004) in their study investigate organization’s culture and reveal that managers’ conduct is always under examination, and they become the model of the actions of subordinates. They find that the former group of employees holds a higher level of individual ethical commitment than the latter. Brass et al. (1998) discuss about the role of social network analysis and evaluate how relationships among individuals can affect unethical behaviour in organizations. Crittenden et al. (2009) suggest that (un) ethical behaviour proposes that ethical decision-making is driven by three main factors: situational ethics, the suitability or consequence of



acts and laws. Jones and Kavanagh (1996) examine the relative effects of situational variables on a decision to engage in an unethical behaviour of individual in the organization. Stead et al. (1990) in their study argue that the ethical behaviour is influenced by two factors; organizational (philosophies of managers and managerial behaviour) and the external factors (like reinforcement system).

Specifically, ethical behaviour is also affected by the ethical codes of other groups relevant to the workplace (Somers 2001). There is also reason to believe that employees prefer an ethical organizational environment (Jose and Thibodeaux 1999), which suggests that established corporate ethical culture with ethical values might enhance employees' basic responses to work. Ethical behaviour, in this sense, grows out from the ethical perceptions of individuals in organizations (Somers 2001).

### 6.3 Unethical Behaviour and Organizational Commitment

Managing unethical behaviour is a critical social problem engaged with organizational culture. We define unethical behaviour as a "*type of behaviour that is illegal or morally unacceptable which may enable harmful effects upon community and individuals*". Ethical context requires an understanding of the many factors which may have a considerable effect on employees' decisions to behave ethically or unethically (Stead et al. 1990).

In the wake of global competition, employees are under pressure like dealing with high levels of stress (push) and the consideration for making money for products and services (pull). These forces may lead people to engage in unethical behaviour (Tang and Chiu 2003). Unethical behaviours can also be encouraged by capitalist market forces in the demise of moral behaviour (Pike 1980). The behaviour to curb unethical behaviour of employees can be managed through training employees and other managerial policies, focusing on developing a culture which clearly engenders ethical norms. It is well known that organizations impose more severe organizational improvements against managers for engaging in these acts (Jones and Kavanagh 1996). This will provide employees the knowledge where the organization appreciates an employee for acting ethically. Managers must support appropriate ethical behaviour, and do so in a manner that is desirable to the recipient (Buckley et al. 2001).

Commitment is associated with the degree to which employees embrace company values and the entire culture (Mowday et al. 1979) that increase the compatibility between individual and company characteristics. According to Herndon et al. (2001), when employees are committed to their organization, they tend to reinforce the existing value structure around them. Following Porter et al. (1974), organizational commitment can be specified by: (1) a strong belief to achieve organization's goals and values, (2) readiness to perform for the goals, and (3) a strong desire to work for the organization (Cullen et al. 2003, 128).

To date, there have been a limited number of studies which have examined the relationship between issues related to ethics and organizational commitment (Hunt et al. 1989; Cullen et al. 2003; Fritz et al. 1999; Oz 2001; Schwepker 2001). The first work that successfully associated ethical values with commitment belongs to the study of Hunt and colleagues, issued in 1989. In terms of corporate ethical values, organizational commitment, and job characteristics, they found that organizational commitment was strongly related to corporate ethical values. Furthermore, if people feel that their organizational values are in conflict with their own ethical values, they are less committed to the organization (Sims and Kroeck 1994; Schwepker 1999).

In the given literature, it is asserted that organizational commitment was predicted strongly by managerial adherence to organizational standards. Fritz et al. (1999) stated that depending on organizational level, organization's ethical awareness was encouraged not only by managerial commitment but also by the organizational compliance with those values. Valentine and Barnett (2003) examined the relationships among awareness of ethics code, perceived corporate ethical values, and organizational commitment. According to the results, respondents demonstrated higher levels of organizational commitment when they were aware of an ethics code in their organizations. Additionally, the relationship between ethics code awareness and organizational commitment was found to be fully mediated by perceptions of an organization's ethical value. Oz (2001), in his study, found that IS professionals were more adhered to their organizations than the other professionals besides, IS professionals were less ethical among issues like software piracy and hacking. Schwepker (2001) examined the relationship between ethical climate, job satisfaction, organizational commitment, and turnover intention of salespeople. The results indicated that salespeople's perceptions of a positive ethical climate were found to be positively related to their job satisfaction and organizational commitment. The converse is also true, since according to Tang and Chiu (2003), the organizational culture influences the relationship between commitment and unethical behaviour negatively. In this study, based on the literature we assume that the organizational commitment is an important factor that leads to decreased unethical behaviour. Therefore, we predict:

**Hypothesis 1a** Organizational commitment *negatively influences* employee unethical behaviour

**Hypothesis 1b** Organizational commitment *negatively influences* managerial unethical behaviour.

### 6.3.1 *Unethical Culture and Organizational Commitment*

Developing an ethical culture has become an essential objective in today's business environment. In an organization, an individual may influence the ethical behaviour of his/her colleagues significantly both through social pressure and formation of various attitudes. To provide employees act ethically, establishing an ethical atmosphere in a company is essential (Chang 1998). Therefore, it can be stated the ethical or unethical behaviour of a firm appears as the determinant of establishing the overall culture of the firm.

Ethical culture is defined in various ways in the given literature. Key (1999) defines ethical culture as "The beliefs about the ethics of a corporation shared by its members". According to Brass et al. (1998), ethical culture involves a consideration of "the others". It is often a fact that in most of the business environment, the formation of ethical culture requires the overall values and judgments of its members (Cullen et al. 2003). The personal values of executives, powered by their authority, determine the ethical tone of an organization. When executives neglect their roles to define ethical standards and support them by establishing appropriate organizational policies, an unethical organizational culture is inevitably established (Sims and Brinkmann 2002).

Early literature on business ethics associates the ethical culture integrating with the behavioural aspects in a corporation (Trevino et al. 1998; Vitell et al. 2006; Sinclair 1993). There is a limited scope of research about the outcomes of relationship between commitment and unethical culture in the given literature. While some researches focus on ethical context in organizations (Trevino et al. 1998), some of them investigated the relationship between corporate codes of ethics and employee attitudes (Somers 2001; Schminke et al. 2005).

Organizational commitment might be one manifestation of an ethical context because committed employees often feel a connection to company values (Schwepker 1999). When ethical values and practices are implemented in the organization, employees feel engaged and committed to the organization. So, they feel less pressure to compromise the organization's standards (Muhtala et al. 2013; Valentine and Barnett 2003). It is also likely that the link between a company and its employees is strengthened when ethical conduct is encouraged in organizations (Sims and Kroeck 1994). Therefore, we predict:

**Hypothesis 2** Unethical culture *negatively influences* organizational commitment.

### 6.3.2 *Unethical Culture and Unethical Behaviour*

Work environments are particularly subject to unethical type of behaviour since this behaviour appears as about putting oneself, first regardless of the impact on anyone else, which includes twisting rules to one's own benefit. The organization can support ethical behaviour by rewarding employees who exhibit the values and integrity.

Unethical culture appears as a critical issue in ethics because it may become a serious and costly problem both in society and in organizations since the firms deal with unethical behaviour on the part of corporate managers and employees (Jones and Kavanagh 1996). Furthermore, every company striving from ethical violations deals with lawsuits that cost money and even bankruptcy (Gonzales 2013). Therefore, investigating the determinants of unethical behaviour is important as it increases consciousness of the factors associated with organizational ethics and ethical decision-making.

Ethical culture helps employees to determine ethical issues in the organization. In other words, the ethical culture serves as a perceptive outlook through which workers assess conditions (Cullen et al. 2003). Gunthorpe (1997) in his study examined the financial markets within ethical business practices. The results revealed that upon the announcement that a firm is under investigation or has in some way involved in unethical behaviour, a statistically significant negative abnormal (excess) return is found. In this study, the basic research is grounded on the assumption that unethical culture is a critical component that leads to unethical behaviour of insurance employees. Therefore, we predict:

**Hypothesis 3a** Unethical culture *positively influences* employee unethical behaviour

**Hypothesis 3b** Unethical culture *positively influences* managerial unethical behaviour.

## 6.4 Ethics in Insurance Sector

Although organizations have begun to invest in increasing the quality of employees' ethics and managing ethically, the organizations are still engaged in unethical business practices despite ethical codes of conduct (Adam and Moore 2004). Major scandals have fostered other companies to raise deep concerns about ethics in business (Egri and Ralston 2008). The managers and companies involved in the recent scandals have suffered both from huge fines, jail terms, and financial collapse (Garrison et al. 2012).

In the financial services, it has become apparent that ethical issues of marketing of services are more important than the ethical issues of the marketing of the normal range of products. There are various characteristics of the financial services sector that create the potential for ethical problems in marketing. Additionally, the problems caused by the dynamic nature and the complexity of financial services also enhance existing ethical dilemmas (Diacon and Ennew 1996a). This is either acknowledged by the recent history. There have been various unethical cases such as insider trading, defence contract fraud, discrimination against minorities, and embezzlement of funds in loan industry (Jones and Kavanagh 1996). Insurance appears as an emerging sector where the ethical practices are mostly observed. As insurance is a marketing and sales

intensive industry, the behaviours of employees have to be in conformity with the codes of conduct, since marketing activities in this industry can cause unethical behaviours like ethical abuse, sales pressures etc.

In Turkey, Insurance Association of Turkey (TSB) has announced the basic ethical principles to be followed by insurance and reinsurance companies. According to the regulation, insurance and reinsurance companies are required to respect the six parts of a regulation in their activities and operations such as general principles, intercompany relations, relations with customers, relations with employees and insurance intermediaries, relations with public institutions and organizations, development of ethical principles in insurance. However, due to some factors, the sector struggles with some ethical issues. This is mainly due to some factors that many insurance products are sold outside of the office. Insurance agents may act in a manner that is incompatible with organizational objectives. Additionally, due to the nature of the service product, insurance agents have the opportunity for ethical misconduct. Another discrepancy is that insurance products are complicated, difficult to understand; consequently, agents have the opportunity to easily misguide consumers (Howe et al. 1994). Insurance sales agents must build a trusting relationship between themselves and their clients to support a long-term, mutually beneficial relationship (Crosby et al. 1990).

Ethical behaviour and honesty should be the first priority of any insurance agent when conducting business for their clients (Head 2008). Therefore, instead of considering what is right or wrong, research has to be focused on the ethical issues and concerns which may arise in marketing-/sales-based sectors. An insurance employee has to assure the clients that he/she will protect them against all or specified risks of loss, acting as a legal duty of a producer. Unless the employee intends to incur greater liability in exchange for competitive differentiation, he/she should maintain a working ethic to treat all policyholders as clients, without actually communicating such promise to the client (Corbin 2006). In an insurance agency, the management should follow the employees through matters such as the proper licensing of employees, fair treatment of competitors, full disclosure to insurers, and faithful control over customers' money. The two areas where producers are most vulnerable are in their stewardship of money and handling of information (Corbin 2006).

When the literature is concerned, there is a limited scope of research (Marcum and Robin 2003; Kurland 1996; Cooper and Frank 1991, 2002; Bellizzi and Hasty 2003) in terms of investigating the unethical behaviour in insurance sector. Howe et al. (1994) examined the relationship between the ethical behaviour and customer orientation of insurance sales agents. Ethical and customer-oriented behaviour was found to be positively related. Haron et al. (2011) investigated the relationships between supervisory influence, role ambiguity, and sales target with the intention to perform unethical behaviour. The study comprised individual insurance agents, and the results showed that there is a relationship between supervisory influence, role ambiguity, and sales target with the intention to perform unethical behaviour. Öncer and Yıldız (2012) investigated multinational insurance companies in Turkey. They found that corporate reputation is highly linked to organizational identification and that ethical culture has a significant moderating role in the relationship between

perceived corporate reputation and organizational identification. Insurance sector with its dynamics can be a good example in ethics if the ethical principles are well implemented. Dynamic business environments are favourable hosts for unethical behaviour because they are easily rule-breaking by nature (Balch and Armstrong 2010).

## 6.5 Research Methodology

### Research Goal

The purpose of this study is to examine the relationship between the organizational commitment, employees’ and managers’ unethical behaviours, and the unethical culture. We propose that unethical culture and organizational commitment have a significant impact on unethical behaviour of employees. In order to analyse the proposition, a research through questionnaires was conducted (Fig. 6.1).

### Measures

The research adopts an exploratory model. The scales in the survey were adopted as a result of a broad literature review which consists of four parts. To measure the organizational commitment, the scale developed by Mowday et al. (1979) and adopted by Schwepker (2001) was used. To measure the ethical attitudes of employees, the scale developed by Abratt et al. (1993) and adopted by Van Zyl and Lazenby (2002), and to investigate the ethical culture, the scale developed by Diacon and Ennew (1996a, b) were used. All the items in the questionnaire were accompanied by a 5-point rating scale (from 1: Strongly Disagree to 5: Strongly Agree).

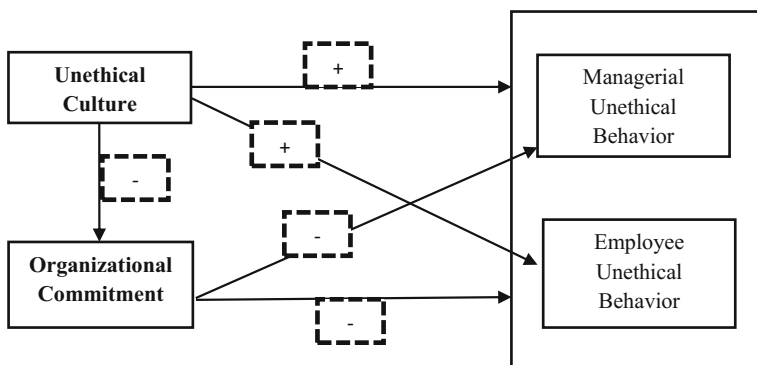


Fig. 6.1 The research model

### **Research Sample**

The research sample represents the white-collar employees in insurance companies in Istanbul, Turkey. A survey was prepared and delivered to 250 people working in various insurance branches. After the deficiently and wrongly completed questionnaires were omitted, there were 180 usable questionnaires in total. In this way, the turnaround ratio is %72.

### **Empirical Findings**

Data was firstly used to examine the demographical traits of the respondents. According to the results, 45% of the participants are male, and 55% of the participants are female. When the age distribution is considered, 54,4% of the participants are aged between 20–30, 36,7% of the participants are aged between 31–40, 7,8% of the participants are aged between 41–50, and 1,0% of the participants are aged 51–60. According to the results of education of the participants, 6,1% are high school graduates; 17,8% have a bachelor's degree; 63,3% have an undergraduate degree; 11,7% hold a master's degree; and 1% of the participants have a ph.d. degree. Work experience of the participants indicate that 57,8% have a work experience of less than 5 year; 25,6% have a work experience of 6–10 years; 7,2% have a work experience of 11–15 years, and 9,4% have been working for more than 16 years.

The factor analysis was conducted among data to reduce the scale into sub-dimensions through varimax method (Table 6.1).

During the analysis, to provide a perfect combination of factor loadings, some items (Mb1, Oc9, Ec4, Ec7, Ec8, Ec10) were excluded from the analysis.

Means and standard deviations were also tested for each variable and created a correlation matrix of all the variables used in the hypothesis testing.

As it can be inferred from Table 6.2, correlation results showed that there is a high negative relation between organizational commitment and manager unethical behaviour ( $r = -.396^{**}$ ), unethical culture ( $r = -.362^{**}$ ), and employee unethical behaviour ( $r = -.167^*$ ), respectively. On the other hand, there is a highly positive relation between unethical ethical behaviour and manager unethical behaviour ( $r = .432^{**}$ ). In addition, there is a positive relation between unethical culture and manager unethical behaviour ( $r = .387^{**}$ ) and employee unethical behaviour ( $r = .307^*$ )

Regression analyses were used to explore the effects of unethical culture, employee unethical behaviour, and managerial unethical behaviour on the organizational commitment. Based on the results indicated in the table below, it can be stated that “model 1” was significant ( $F = 9.618$ ;  $p = .00$ ). *Hypothesis 6.1a* posited that organizational commitment has a negative effect on employee unethical behaviour. Therefore, this hypothesis was *not supported* ( $\beta = -0.64$ ;  $p = .406$ ). *The Hypothesis 6.1b* posited that organizational commitment has a negative effect on managerial unethical behaviour. This hypothesis was *either supported* in the study ( $\beta = -.294$ ;  $p = .000$ ) (Table 6.3).

Model 2 was also found significant ( $F = 25.729$ ;  $p = .00$ ). In model 2, *Hypothesis 6.3a* posited that unethical culture has a positive effect on employee unethical

**Table 6.1** Factor analysis of employee unethical behaviour

Instrument items	Loadings			
	MB	OC	EC	EB
My supervisor does not report the violation of company policies caused by colleagues	.806			
My supervisor consents to violate company policies if necessary	.748			
My supervisor does not hesitate to report incorrect data	.712			
My supervisor accepts gifts which make a concession	.708			
My supervisor admits the success of the colleagues as his own while accepting compliments	.694			
My supervisor often wants help from employees to seize the confidential information from competitors	.683			
My supervisor lures mind of employees from competing firms and transfers them	.660			
My supervisor accuses of other workers for his/her own mistakes	.660			
My company always encourages me to show a high level of efficiency		.824		
My company always inspires me to show a high level of efficiency		.802		
I am glad to choose to work for this company instead of other companies		.770		
I share the idea of working with the company that I work for in my environment in any circumstances		.752		
I am proud to be a part of the company		.726		
My personal values are consistent with the company I work for		.707		
I put all my efforts to contribute to the success of the company that I work for		.517		
I would agree to any type of company for continuity		.421		
The company often plays on financial indicators in anticipation of damage the firm's long-term interests			.774	
My company produces reasons to avoid reimbursements despite invalid excuses			.767	
My company does not hesitate to play for non-data tampering with the actual profit margin of the company			.760	
My company supports the use of misleading marketing strategies to increase sales of the company			.681	
My company often competes unfairly over other companies to be able to market the business			.596	
My company takes into account the customer complaints and works for a solution that makes the necessary guidance			.593	
My company protects confidentiality of customer information			.510	
My company treats the agents' commissions fairly			.440	
My company demands high prices to the customers for the jobs not involved			.427	

(continued)



**Table 6.1** (continued)

Instrument items	Loadings			
	MB	OC	EC	EB
I often spend my time for personal work in business				.830
I often inform my sickness to avoid working				.827
I do not hesitate to use company products for my own personal interests				.788
I do not hesitate to share confidential information with people outside the company				.780
I declare the costs as invalid				.688
To finish a job takes longer than it should be				.552
I often use my company’s opportunities for my own purposes				.548

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. TVE: 56.018 (EB), Managerial Unethical Behaviour (MB), Organizational Commitment (OC) and Unethical Culture (EC)

**Table 6.2** Means, standard deviations, correlations among variables, and alpha reliability

	Mean	SD	Alpha	1	2	3	4
Organizational commitment	2.2504	.67275	0.871	1			
Unethical culture	3.9886	.62869	0.817	-.362(**)	1		
Employee unethical behaviour	4.5377	.53243	0.819	-.167(**)	.307(**)	1	
Manager unethical behaviour	4.2699	.65002	0.895	-.396(**)	.387(**)	.432(**)	1

\*\*Correlation is significant at the 0.01 level (2-tailed)

\*Correlation is significant at the 0.05 level (2-tailed)

behaviour. This hypothesis was supported ( $\beta = -.284$ ;  $p = .000$ ). Additionally, the Hypothesis 6.3b (unethical culture positively influences managerial unethical behaviour) was also supported ( $\beta = .281$ ;  $p = .000$ ).

Model 3 was significant ( $F = 26.759$ ;  $p = .00$ ) as Hypothesis 6.2 posited that unethical culture has a negative effect on organizational commitment. This hypothesis was supported in the study ( $\beta = -.362$ ;  $p = .000$ ).

Before investigating the relationships among the variables obtained as a result of factor analyses, we tried to find out the differences of demographic factors measured by categorical (nominal) measures that may affect these variables. Accordingly we conducted variance analyses to compare the means for each variable concerning the differences of gender.

**Table 6.3** Regression results

Dependent variable: Employee unethical behaviour <b>Model 1</b>			
	Standardized coefficients	<i>t</i>	Sig.
	Beta		
(Constant)		11.009	0.000
Unethical culture	<b>.284</b>	<b>3.713</b>	<b>0.000</b>
Organizational commitment	-0.64	- .834	0.406
<i>R</i> <sup>2</sup> = 0.098 <i>F</i> = 9.618 <i>Sig.</i> 0.000			
Dependent variable: Managerial unethical behaviour <b>Model 2</b>			
	Standardized coefficients	<i>t</i>	Sig.
	Beta		
(Constant)		10.313	<b>0.000</b>
Unethical Culture	<b>.281</b>	<b>3.958</b>	<b>0.000</b>
Organizational Commitment	<b>-.294</b>	<b>-4.148</b>	<b>0.000</b>
<i>R</i> <sup>2</sup> = 0.225 <i>F</i> = 25.729 <i>Sig.</i> 0.000			
Dependent variable: Organizational commitment <b>Model 3</b>			
	Standardized coefficients	<i>t</i>	Sig.
	Beta		
(Constant)		12.563	<b>0.000</b>
Unethical culture	<b>-.362</b>	<b>-5.173</b>	<b>0.000</b>
<i>R</i> <sup>2</sup> = 0.131 <i>F</i> = 26.759 <i>Sig.</i> 0.000			

As a result of the t test for the gender groups’ differences concerning their perception level of employee unethical behaviour (see Table 6.4), it is found that the female’s mean unethical behaviour in the insurance sector is significantly (at 0.05) higher than the male’s; while concerning the other three variables, female–male difference is not significant. This means that the women employees currently employed in insurance companies are more liable to unethical behaviours compared to men employees.

Analysis of variance was conducted in order to understand if any variance exists between the groups of possible categories of answers for the following questions such as work experience and sector experience. For those variables that produced a significant variance, we conducted post hoc Duncan tests to understand the differences between the means for each category, where categories of answers are displayed in an ascending order, concerning the values of the means on a scale from 1 to 5.

Table 6.5 shows that levels of employee unethical behaviour is significantly different, concerning different levels of work experience (*F* = 3.928\*\*). Table 6.6 shows the significant differences between the means for each level of work experience. Sector experience is another categorical factor that produces significantly a variance for the variables of unethical culture (*f* = 4.102\*\*) and employee unethical behaviour (*f* = 2.608\*); Table 6.8 shows the categories causing these differences.

**Table 6.4** T test for gender groups' statistics

	Gender	N	Mean	Std. deviation	Sig.	T-value
Organizational commitment	Female	99	2.2751	.63418	.105	.543
	Male	81	2.2202	.71996		
Unethical culture	Female	99	3.9960	.64382	.789	.174
	Male	81	3.9796	.61356		
Employee unethical behaviour	Female	99	4.6027	.42523	<b>.023</b>	<b>1.822*</b>
	Male	81	4.4583	.63337		
Managerial unethical behaviour	Female	99	4.3783	.59285	.258	2.511
	Male	81	4.1373	.69463		

\*\* Significant at the 0.01 level, \* Significant at the 0.05 level

**Table 6.5** Results of the analyses of variance

Variables	Level of work experience	Level of sector experience
	F	F
Organizational commitment	.771	.925
Unethical culture	2.461	<b>4.102**</b>
Employee unethical behaviour	<b>3.928**</b>	<b>2.608*</b>
Managerial unethical behaviour	.644	.738

\*\* Significant at the 0.01 level, \* Significant at the 0.05 level

**Table 6.6** Results of the Duncan tests: means of employee unethical behaviour for different levels of work experience

	N	Subset for alpha = 0.05
<b>Work experience</b>		<b>1</b>
0–5 years	104	4.4256
6–10 years	46	4.6636
16 years and above	17	4.7311
11–15 years	13	4.7363
Sig.		.059

The results of the Duncan tests for the level of work experience are summarized in Table 6.6. According to findings, the employees with 11–15 years of work experience show significantly more unethical behaviour than all the others. This shows that the more the experience, the less the ethical behaviour.

The results of the Duncan tests for the level of sector experience are summarized in Tables 6.7 and 6.8. According to the firms with 16 years and above sector experience which show significantly more unethical culture than the firms with 0–5 years' sector experience, this shows that the insurance companies operating in the industry for more than 16 years do not have as much the ethical culture as the new entries.

**Table 6.7** Results of the Duncan tests: means of unethical culture for different levels of sector experience

Sector experience	N	Subset for alpha = 0.05		
		1	2	3
0–5 years	77	3.8488		
6–10 years	52	3.9735	3.9735	
11–15 years	24		4.1551	4.1551
16 years and above	26			4.2959
Sig.		.393	.214	.334

**Table 6.8** Results of the Duncan tests: means of employee unethical behaviour for different levels of sector experience

Sector experience	N	Subset for alpha = 0.05	
		1	2
0–5 years	77	4.4283	
11–15 years	24	4.5179	4.5179
6–10 years	52	4.6227	4.6227
16 years and above	26		4.7198
Sig.		.144	.129

And finally, as shown in Table 6.8, the firms with 16 years and above sector experience show significantly more employee unethical behaviour than the firms with 0–5 years’ sector experience.

## 6.6 Conclusion

For several decades, the importance of ethics has been subject of some old and recent studies. In order to provide ethical culture, it is important that responsible authorities should avoid any unethical behaviour in an organization. Although this area of research is potentially useful, little evidence has been conducted to date. This study contributes to the field of business ethics by assessing the effects of unethical culture and unethical behaviour of employees’ and managers’ on organizational commitment in insurance sector. Since the sector serves as the engine of the financial industry, it becomes critical for insurance companies to guide and preserve the ethical culture in their organizations.

There is a limited number of evidence in the empirical research conducted on organizational ethics in the financial sector. Insurance companies’ ethics include the interaction not only between managers and employees but also between companies and society in a broader framework. The ethical culture determines how employees are supposed to treat insurance policy owners’ agents and other employees. It is top management’s duty to incorporate and manage a strong ethical culture within the business. In this respect, companies may have certain ethical guides to be followed but they may be inefficient in interacting with their own employees. Therefore, the

managers' ethical behaviour and employees' ethical perception of their manager's behaviour are important.

According to the finding of this research, organizational commitment in insurance companies is found to be much more effective on the managerial unethical behaviour. Also, there is a positive relation between unethical culture and managerial unethical behaviour and employee unethical behaviour. However, organizational commitment has no effect on employee unethical behaviour, while it affects the managerial unethical behaviour. Another contributing conclusion is the effect of unethical culture on organizational commitment. The women employees currently employed in insurance companies are more liable to unethical behaviours compared to men employees. The employees with more than 10 years of experience show significantly more unethical behaviour than all the others. This shows that more the experience, less the ethical behaviour appears. Another finding is that the firms with 16 years and above show significantly more unethical culture than the firms with 0–5 years' sector experience. This shows that the insurance companies operating in the industry more than 16 years do not have as much the ethical culture as the new entries. The firms with more sector experience show significantly more employee unethical behaviour than the firms with limited sector experience.

## **6.7 Further Discussion**

Unethical organizations that make decisions at the expense of their employees might suffer negative consequences associated with these decisions. Unless managers of insurance companies are determined about ethical values and principles, unethical behaviour will unfortunately persist increasingly. When the relation between ethical behaviour and ethical culture is questioned, there is still a great deal of room for improvement. The study is grounded on the contextual behavioural perspective to assess the proposed relationships that have not fully been explored in the business ethics literature.

While this study covers the primary aspects of organizational unethical behaviour within the ethics in insurance sector, it has some limitations. The sample in the study does not cover insurance agents operating in Turkey, which could have had an impact on the overall results. Also, other work-related variables, such as job satisfaction, performance, trust, motivation which have not been included in the study, could be another limitation. Further improvement may be made by investigating the effects of potential mediating or moderating variables on the proposed relationships, concerning both the insurance sector and the banking sector.

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# Chapter 7

## Ethics in the Auditing Company



Ayşe Pamukcu and Nevber Zeynep Eroğlu

### 7.1 Introduction

The reporting of the real condition of accounting information systems of businesses to users in the right time depends on many elements. The most important of these is the profession members creating the accounting information to provide only what it should have been without considering the advantages of any party or group. The trustworthiness of the information created in the activities realized with this objective is in direct proportion with the independency of the profession members and their compilation to the ethical rules. Relevant professional organizations are performing important studies on this subject in the world and in Turkey. The objective of this study is to display the importance of the compliance to ethics rules in accounting, and in this way, the highest advantage expected from the accounting profession will be received from the audit profession. The concepts of ethics and ethics in accounting are explained primarily. Then, the effect of ethics in accounting to the audit profession is analyzed considering the studies in the world and in Turkey.

### 7.2 Ethics in Accounting

#### 7.2.1 *Description of Ethics in Accounting*

Ethics can be described as unwritten group of rules determined and developed for the individuals in a community to live in harmony (Arens et al. 2006: 74). Ethics is the expression of correct and incorrect measures related to today and the past, whereas morality is the aggregate of type of the behavior with the relevant values, norms, and principles (Bayraktaroğlu et al. 2005: 377).

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Even though the concepts of ethics and morality are used in the same meaning, there are some minor differences between them. Ethics is a discipline dealing with what is right and what is wrong related to the ethical tasks and obligations. But morality is the valuation made about human behavior and the goodness and badness of human character to differentiate between the good and the bad. Thus, good and bad, correct or incorrect, and thinking about what is good or bad is accepted as ethics (Aymankuy and Sariođlan 2005: 26).

Ethics in general can be defined as values governing the correct or incorrect behavior of an individual or a group. In other words, it is creating an ideal human sample that can control himself in a degree over the legal requirements. Standards determining what is correct or incorrect during the decision-making phase of the individual or the group are established by the concept of ethics. Ethics rules monitor individual or societal decisions by filling in the gaps between what should be done and what should not be done as it is determined by the law and what one would like to do in an independent behavior (Sanlı 2002: 86).

Enterprises are businesses operating in specific environmental conditions, and they both are effected from and effect the environment in the decisions they make. In this mutual interaction, professional ethics covers the responsibilities to the company, personnel, shareholders, and the environment. Namely, professional ethics is made up of the responsibilities of all the elements in the micro-framework to each other. In short, it expresses the discipline within a company and because of this reason requisitions and rules to be abided are very open and clear. Then professional ethics can be defined as: "Group of principles and rules based on beliefs about what is correct and incorrect, what is just and unjust related to professional behavior" (Selimođlu 2006: 440).

Professional ethics can be defined as the whole of the standards and moral principles monitoring the behavior in the business world. Along with the effect to those concerned in the enterprises businesses to establish a harmony with the ethical values and provision of their social responsibilities, an effect on the whole economy and economic efficiency is at stake (Müslümov and Aras 2002: 59). Instruments used in the examination of morality are a series of principles related to "what should be done," rules, values, and thoughts. Opinions dependent on principles and standards related to moral behavior generally arise from religious and philosophical thoughts, cultural values, laws, and human conscience (Selimođlu 2006: 440).

Ethics in accounting is the presentation of transactions consistent with the laws as well as trustworthy information provided with a consideration of the current value judgments of the society to the community (Gül and Ergün 2004: 57). All the rules that accountants who are the implementers of the profession must abide while carrying their own responsibilities and those to the society are called professional ethics (Sözbilir and Yenigün 2001: 31).

Another definition on the subject of accounting ethics expresses the independency, self-control, and honesty of the person who is the member of the profession. Stated differently, professional ethics in accounting is serving the customers, public, and other implementers with moral behavior adhered to high standards. If it is the service to be considered, the profession members must be persons who must have reached the

adequate responsibility in expertise, must have furnished the trustworthiness, must have been individuals having the accurate and impartial qualities. On the other hand, the society has some expectations from the profession members, and therefore, those having the duty of executing the accounting and audit profession have responsibilities to the society as well (Çiftçi and Çiftçi 2003: 82).

Accountant measures financial events and while performing these measures use the accounting concepts and principles that have denotations. The accountant values the financial event with these concepts and principles. Accounting cannot perform these measurements without the concepts and principles. While accounting performs this measure with these concepts and principles, accounting ethics is the integration of accounting concepts and principles and the ethics systems for the correct measurement. This integration forms the system of concepts in accounting ethics (Ünsal 2008: 2).

### ***7.2.2 Requirement of Accounting Ethics***

The objective of the professional ethics is to establish a series of a whole of enhancing principles which provides the trust of the society in the products and services of businessmen. American Institute of Certified Public Accountants (AICPA) constitutes a whole of principles for those providing the accounting necessities of the society in the area of accounting and assumes the compulsory duty in this subject (Smith and Smith, Trans: Bekçi 2007: 383).

An unethical behavior performed in the accounting profession can spread to the whole society. For example, in the case of reflecting the financial table data unrealistically and a tax evasion as a result of an unethical behavior, an effect that spreads to the whole society arises (Kutlu 2008:148). The accounting profession has an importance that is as important as other professions from the point of view of the welfare of the society, and there is a need for the accounting profession that is as much as the need for other professions. Thus, accountants establish an important place in the ranking made among the professions in the community because accountants have two basic duties as to serve to the advantage of the community and to protect their rights. This is why the individuals performing the accounting profession must have high professional ethical standards so that they can both gain the trust of the community and that they can compete with each other easily in the competing environment of the market. The validity of the professional ethics is in direct proportion with the increase in the trust and respectability of the community to the profession and its activities. Professional ethical principles established from the accounting point of view must be put into writing and must be variable, voluntary, and discussible as to personal opinion. Professional ethical principles put into writing form the base for the formation of the professional standards law. This in turn provides the society to have a law and make a judgment about the profession. In this context while the standards perform the guidance duty for those who enter the profession, the feeling of having a measure is created in those who are executing the profession (Selimoğlu 2006: 442). Professional ethics standards determined and put into writing for those

in the accounting profession are applied to the members of the organizations determining them, and those who are not abiding those standards are penalized by these associations where this protects the profession members from being humiliated in the public opinion and even glorifies them (Selimoğlu 2006: 443).

### 7.3 The Effect of Accounting Ethics to the Audit Profession

#### 7.3.1 *Ethics in the Audit Profession*

As in all professions, whether an independent accountant, management accountant, or internal auditor, members of the accounting profession can live moral dilemmas in their business lives. The ideal in cases which can be a cause for conflict of interests is to be able to act as to high behavioral standards even though it may sometimes be in conflict with personal interests in addition to the responsibilities to the public and to the employer (Toraman and Akcan 2002: 105). As there is not a specific relation between the content of the audit report to a specific result in accounting many times, morality institution takes the form of a causality question. Moreover, the subjects of the accounting profession, even in a very clear subject, are in a form such that two different accountants may reach two different results. In contrast to all these drawbacks, the most distinct precaution taken by organizations related to accounting is to establish the ethical rules of the profession. The presence of ethical rules tries to provide guidance in ambiguous cases by bringing a boundary to the unethical behavior (Toraman 2002).

#### 7.3.2 *Audit Ethics in the World*

Ethical rules to be compiled by the members of professional jobs are shaped within the framework of principles determined by international institutions and international professional organizations.

##### (a) **Professional Ethic Rules of The International Organization of Supreme Audit Institutions (INTOSAI)**

The principles monitoring the INTOSAI Professional Ethics Rules are set in the following headlines (Koçberber 2008: 71–73; Kesim 2005: 275).

**Honesty:** Honesty is the most important INTOSAI ethical rule. In general, honesty is measured by the concepts of accuracy and justice. In order for the trust felt toward them to be kept continuous, the behavior of the auditors must be faultless and in a manner that does not cause suspicion. While executing their duties and continuing their relationships with the audited personnel, auditors must stick to high standard

behavior patterns. Honesty requires the auditor to adhere to the independency and impartiality principles, to abide to the faultless behavior standards required by the profession, to make decisions considering public interest, and to show complete honesty in the execution of duties and the use of the resources of the Supreme Audit Association.

**Independency:** Auditors are to be independent from the institution they are auditing and are to handle the examined subjects in an objective manner. The independency principle is shaped by two sub-principles under the headings of “objective behavior” and “impartiality.” The independency of the auditors must not be damaged in any way by personal or external interests. Auditors must abstain from getting involved in all kinds of subjects where their benefits may exist. In all the work executed by auditors, especially in auditor reports which must be accurate and objective, objectivity and impartiality are required. Therefore, it is a must that the opinion and result sections of the reports must be based on proofs collected and gathered in accordance with the Supreme Audit Association’s audit standards.

**Impartiality:** It is utmost important that the preservation of the political impartiality of Supreme Audit Association exists in reality and its existence is perceived by the publicity. Therefore, auditors must pay careful attention to stay away from political influences to be able to perform their audit responsibilities in an impartial manner. Supreme Audit Associations, as they are in close working relationships with the legislative and executive bodies or with other governmental associations which have been granted the authorization to discuss their reports, the auditors must stay away from political influences. When auditors participate in a political activity or think of being part of one, they must act after considering the effects such an activity may have on their obligations of performing audit duties impartially or considering that it might seem so from outside. If auditors are granted the permission to carry political activities, auditors are to carry on these activities in a manner that does not create professional conflicts.

**Prevention of Conflict of Interest:** Auditors must preserve their independency and prevent a possible conflict of interest by refusing gifts or cash bonuses which may damage their independencies and honesty or which may be the cause of such an image. Auditors must abstain from all kinds of relationships that may threaten or that may cause them to compromise from their independency in their relationships with the managers, personnel, and others concerned in the audited corporation. Auditors must not use their official positions for their personal benefits and must keep away from relationships that may include bribe risks and from relationships that may give rise to suspicions about their objectivity and impartiality. Auditors must not use the information they have gathered during the execution of their duties to provide individual benefits for themselves or for others.

**Preservation of Professional Secrets:** Auditors must not expand the information they have received during the audit process to third parties either verbally or in writing. However, explanations made to fulfill their responsibilities determined by laws and other legal adjustments as a requirement of the ordinary study of the Supreme Audit Association are excluded from this.

**Professional Adequacy and Being Open to Professional Development:** Auditors must know the current audit, accounting and financial management standards, policies, procedures, and applications and must implement them. Moreover, auditors must have enough knowledge about the constitutional, legal, and corporate principles and standards that monitor the activities of the audited corporation. Auditors must use the possible highest quality methods and applications in their audits. Auditors must not assume any job in subjects in which they are inadequate.

(b) **Ethic Rules of the International Federation of Accountants (IFAC)**

IFAC has considered the ethical rules that could be applied to all professional accountants or accounting profession members or International Accounting Ethic Principles in its widespread terms under the following headings (Ayboğa 2001: 39; Çabuk and İşgüden 2006: 69):

**Accuracy and Impartiality:** Honesty requires being realistic and accurate too. Impartiality predicts the accountant to stay away from all kinds of conflicts of interest. Accountants are to display their honesty and impartiality in various cases. These cases vary according to the service type they provide. In some cases, they may encounter some influences that may effect their honesty. It will not be realistic to try and define all these influences or similar conditions. Member of profession must especially abstain from acts that may be disadvantageous, that may create losses, or that may affect the honesty of others or even give rise to such a suspicion. Moreover, they must enable the adherence of the personnel they have hired to the principle of honesty. They must not accept gifts or similar benefits that may effect their honesty in the work they perform in a negative way from people that they have business relationships.

**Resolution of Ethical Disputes:** Profession members may sometimes encounter conditions that may create conflicts of interests. These conditions may span from daily problems to fraud or similar illegal activities. It is hard to list such type of events in a ranking. Members of profession must be conscious and be aware of such events. However, an honest difference of opinion between the member of profession and the other party may not necessarily be the subject of ethics. Each event must be evaluated in its own framework.

**Professional Adequacy:** Members of the profession should not introduce themselves as if they have the expertise and experience they have not got. Professional adequacy is considered in two separate phases of the acquisition of the professional adequacy and the preservation of the professional adequacy. The acquisition of the professional adequacy requires special education oriented toward the profession, practical education and practice, examinations in professional topics, and a specific period of professional experience after a general education of high quality. The preservation of the professional adequacy requires the close follow-up of all kinds of professional topics in the national and international developments related to accounting and audit, the innovations in the accounting profession including the amendments in the laws and regulations to keep the information updated. Member of profession must be sub-

jected to a quality control programs consistent with the national and international implementations.

**Confidentiality:** Member of profession must pay respect to the confidentiality of the received information related to the businesses of his customer or employer. This confidentiality continues after the relationship between the accountant and his employer ends as well. Unless an authorization is granted to verbalize the information or unless there is a legal obligation, the confidentiality principle must always be preserved.

**Tax Implementation:** Member of profession providing tax consultation has to enable his customer or employer to be in his best condition and to perform his profession in a professional understanding, not to give up honesty and impartiality and to work in consistency with the law. In cases of controversial issues, provided that there is adequate support, solutions to the advantage of the customer or the employer must be pursued. Member of profession preparing a tax declaration must remind the customer or the employer that the real responsibility is rested on them. The proposals or opinions on tax subjects presented to the customer or the employer and those that have a tangible result must be recorded in the form of a text or information format to be filed.

**Cross boarder activities:** Member of profession performing cross boarder activities must deal separately with each and very duty whether it is in his own country or abroad, in the country where the service is provided. Members of profession must provide their services in consistency with the moral realities of the countries they are in. If there is a distinct difference between the ethic requirements of two countries, IFAC ethics rules are applied if the ethical requirements in the country where the service is provided are less tight than the IFAC ethics rules; the ethics rules of the country where the service is provided are implemented if the ethics rules of the country are tighter than the IFAC ethics rules.

**Presentation:** During promotion and marketing, members of profession must not use tools that can damage the honor of the profession, must not make exaggerated assertions about their adequacies and experiences, and must not make accusations to their colleagues. The following ethical rules listed as headings are determined for accountants performing independent professional activities along with the IFAC ethics rules determined for all members of the profession:

- (a) Independency,
- (b) Responsibilities about using those who do not have professional adequacy and who are not accountants,
- (c) Fees and commissions,
- (d) Applications inconsistent with independent accountancy,
- (e) Relationships with other accountants performing other self-employed practices,
- (f) Public welfare applications,
- (g) Advertisements and incentives.

Moral rules applicable to accountants working dependently are determined under the headings of loyalty conflicts, support to colleagues and professional adequacy, and presentation of information by IFAC:

**(c) Ethic Rules of International Internal Auditors Institute (IIA)**

International Internal Auditors Institute has prepared the ethical rules that must be obeyed by its members. The objective of determining the ethical rules has been explained by the institute to be as to establish and to spread the ethical culture in the internal audit profession. Four basic principles have been determined for ethical rules.

They are: honesty, impartiality, professional efficiency, and keeping secrets. Eleven behavior rules have been set within these four main principles. These are (Koçberber 2008: 76–77):

- (a) Members and Certified Internal Auditors (CIA) will be honest, objective, and diligent when performing their duties and responsibilities.
- (b) Members and CIA will be loyal in all topics related to the problems of the corporations or to the persons they provide services. But members and CIA will not be a part of any improper or illegal activity consciously.
- (c) They cannot participate in activities that do not suit their associations or the internal audit profession consciously.
- (d) They must abstain from getting involved in activities that is in conflict with the interests of the association or that hinder the objective performance of their duties and responsibilities.
- (e) They cannot accept any precious thing/gift from employees, customers, sellers, and persons and corporations with which they have corporate relationships and that may damage or that are expected to damage their professional decisions.
- (f) They can only assume services that they expect to complete using their professional efficiencies.
- (g) They utilize the suitable methods so that they are consistent with the “Internal Audit Implementation Standards.”
- (h) They have a common sense while they are using the information they have received during their duties. They will not use confidential documents for their individual benefits just as they will not use them in an illegal way or in a way to harm the corporation.
  - i) While reporting the results of businesses, they display realities based on all the documents they know. If these realities are not displayed, the activity reports examined may be distorted or illegal applications may be hidden.
- (j) They show continuous effort for the improvement in their expertise and for the quality and efficiency of services.
- (k) They will be conscious of the responsibility of preserving the adequacy, morality, and reputation high-quality standards informed by the “institute” in professional applications. Members abide “decrees” and support the goals of the institute.

**(d) Ethic Rules of the American Institute of Certified Public Accountants (AICPA)**

AICPA Professional Behavior Law consists of 11 ethic rules determined by 6 principles. The six principles monitoring the AICPA Professional Behavior Law are



organized under the headings of: responsibility, public interest, honesty, impartiality and independency, attentive study, and the coverage and quality of the services provided (Yüksel 2001: 239). The 11 rules established by the AICPA Professional Behavior Laws are determined as follows:

**Independency:** Member of profession must be fully independent of the related company while performing profession. To be in a financial relationship, to be in a business relationship, to provide management consultation, and to have a legal dispute for the auditor personally or with the customer of the audit firm, it is working with are accepted as elements damaging the independency. The auditor or the accountant must be independent when performing the audit service.

**Honesty and Impartiality:** Member of profession must be honest and impartial when performing works.

**General Standards:** There are four general standards that all members must abide. These standards are: professional adequacy standard, professional attentiveness standard, planning and audit standard, and adequate and valid data standard.

**Complying with the Standards:** Members must abide to the standards published by the related professional organizations when performing their professional activities.

**Principles of Accounting:** These principles are principles published by the State Accounting and Financial Accounting Standards Boards and are valid for all members.

**Confidentiality of Documents Related to the Customer:** The accountant cannot announce the information received without the permission of the customer. In case there is a court call, the member is to comply with it and is responsible to transfer the acquired information to the related and responsible persons.

**Conditional Fees:** Member of profession can never accept fees proposed toward the distortion of realities.

**Improper Behavior:** Improper behavior is acts damaging the name of the profession and its honesty. These behaviors are;

- Keeping the records related to the customer and audit work papers secret and not returning them to the customer,
- Creating exceptions in employment,
- Not abiding accounting principles, standards, and rules,
- Acting negligent in the preparation of financial tables.

**Other Kinds of Demands Related to Advertising and Service Sales:** Member of profession cannot attract customers by false and deceiving advertisements and declarations. Performing business by exerting pressure, by disturbing, and by deceiving is strictly forbidden.

**Commissions and Consultation Fees:** No member of profession can ask for a commission or a similar fee from customers for a good or product or for providing recommendation or for the introduction to another colleague.

**Style of the Execution of the Profession and Name:** As to this rule, the member of profession can work as a personal business, ordinary partnership, or corporation to

perform the profession. The name used must not be misleading. For example, using the name of a separated or dead partner is not the right way of acting.

## 7.4 Audit Ethics in Turkey

### (a) Internal Public Auditors Professional Ethics Rules

The ethics rules that the internal auditors will abide to be determined by the Internal Audit Coordination Board are expressed in Public Financial Management and Control Law No: 5018 Article 67; paragraph (k) (Koçberber 2008: 80–83; Kesim 2005: 277–278). Moreover, it is also expressed that internal auditors are obliged to comply with the audit standards and ethical rules stated at the 9th Article of the Procedure and Basis of the Internal Auditors Working Regulations, where these standards and rules are to be determined considering the international generally accepted standards and rules. Within this framework, Internal Public Auditors Profession Ethics Rules are established by Internal Audit Coordination Board taking the Profession Ethics Rules of the International Internal Auditors Institute (IIA) and by utilizing the texts of other professional associations. Professional ethics rules of internal auditors are organized under these headings:

**Honesty:** Honesty of internal auditors provides trust and thus enhances a basis for the trust in the opinion and valuations that they reach.

**Impartiality, Objectivity, Independency:** Internal auditors show high-level professional impartiality when they are gathering information related to the audits they perform, evaluate, and report. Internal auditors then perform evaluation and all related conditions in a just and unprejudiced manner and are not effected from the benefits of himself or others.

**Confidentiality:** Internal auditors respect the confidentiality of the information acquired during audit and cannot publish or announce these unless there is a legal obligation.

**Authority (Efficiency/Capability):** Internal auditors display the information, skill, and experience required to perform the internal audit services.

Behavior rules the auditors must comply with within the framework of these principles are determined as such.

**Honesty:** Internal auditors will comply with the following honesty rules:

- (a) They act with the feeling of fairness and responsibility.
- (b) They guard the law and make the special case explanations required by law and profession.
- (c) They do not become part of an illegal activity consciously and on purpose or do not get involved in infamous acts from the internal audit and management aspects.

- (d) They respect the legitimate and ethical objectives of the management and make contribution.
- (e) They consider public benefit in the decisions made.

**Impartiality, Objectivity, Independency:** The matters that internal auditors will have to consider while performing the duty as a requirement of the impartiality, objectivity, independency principles are listed as the following.

- (a) They are independent and impartial in the handling of problems and in topics in the area of duty.
- (b) They protect their independency from all kinds of political effects.
- (c) They resist personal or corporate internal or external interests and pressure.
- (d) They accept opinions proposed by the audited unit and other parties, but constitutes the decision with their free will.
- (e) They prepare the audit reports in a correct and objective way (results must be dependent only on the acquired proofs and must be combined in consistency with the audit standards).
- (f) They will not be a part of any activity or relationship that invades or that may invade independency. This condition is valid for activities and relationships that may collide with the interests of management.
- (g) They will not accept any interest/benefit damaging or that may damage the auditors make a professional judging.
- (h) They display all important findings that may ruin the soundness of the report related to the audited activity if it is not announced and even though it was known.

**Confidentiality:** Internal auditors will pay attention to the following issues as a requirement of the confidentiality principle while performing their duties.

- (a) They will be cautious in the protection and usage of the information acquired during duty. However, they inform any activity that is illegal or is accepted as immoral to the authorized bodies as a requirement of statute.
- (b) They cannot use the acquired information for personal interests or illegally or in a manner that may harm the legitimate and ethic goals of the management.

**Competency:** Internal auditors must conform to the following when performing their duties.

- (a) They only assume the duties in which there is the information, ability, and experience required by their duty.
- (b) They perform the internal audit services consistent with the public internal audit standards.
- (c) They develop their own adequacy and the efficiency and quality of services continuously. If the internal auditors are providing consultation or other services to the audited unit, they must pay close attention for these services not to be a case of conflict of interests. The following rules are determined for the internal auditors to keep away from conflicts of interests:

- (a) They must be sure that services of this kind are not among the original authorization and responsibility area and that these topics must certainly left to the unit management.
  - (b) They reject any benefit effecting or that may be assumed to effect their independency and impartiality.
  - (c) They abstain from relationships with the managers, personnel, and other related parties of the unit that threatens, effects, or that may be assumed to effect their independent behavior. This case includes the relationships and activities that may be in conflict with the management interests.
  - (d) They cannot use their official position for their private goals and they abstain from relationships that include corruption risks or that may give rise to suspicion about the impartiality and independency of the auditors. Profession ethic rules of public internal auditors are read and signed by internal auditor when they are introduced in the profession and must be presented to the internal audit unit and top manager.
- (b) Occasions that require disciplinary proceedings about commissioners of audits and internal regulation about the disciplinary penalties to be imposed on them**

The regulation “Occasions that require disciplinary proceedings about audit commissioners other than the President and members; and internal regulation about the disciplinary penalties to be imposed on them” is issued in the year 1968 which is also the disciplinary regulation of auditors and includes some arrangements for auditors for ethical denotations.

In the mentioned regulation adjustments with ethical denotations are organized under the headings “Attire,” “Relationships with Officers,” “Relationships with Non-officials,” “Personal Attitudes and Behavior” (Koçberber 2008: 83).

With the Additional Article 10 under the heading Efficiency and Effectiveness Valuation to Article 8 of Law No. 4149 added to Audit Commissioners Law No. 832, the clause of “Audit Commissioners are authorized to examine the extent to which the audited enterprises and corporations use resources efficiently and effectively. The results of this investigation are presented to the Grand National Assembly of Turkey Presidency by the Auditor General with an audit report. These reports and other reports predicted by the Law in general are discussed at the Grand National Assembly Plan and Budget Commission and is presented to the Grand National Assembly of Turkey together with the Commission Proposal” has been introduced. As a prerequisite of Article 160 of the Constitution while the audits performed by Auditor General in the name of the Grand National Assembly of Turkey of all the income and expenses of the offices with general and supplementary budgets were limited with the realization of a regularity audit of examining whether the transactions complied to the laws and other arrangements; with this new adjustment the Auditor General was given the authority to perform an audit of performance evaluation in the form of examining whether these corporations and enterprises used the resources economically and effectively, and the results were envisaged to be presented to the

presidency of the Grand National Assembly of Turkey by an evaluation report. In this way, from the responsibility point of view of the accountability of the management it was enabled to contribute to its audit by the legislative body.

With the Additional Article 12 of Auditor General Law No. 4963 Article 7, “based on the decisions of the Grand National Assembly of Turkey’s inquisition, investigation, and expertise commissions; and with the request of the Presidency of Grand National Assembly of Turkey; Auditor General can audit the accounts and transactions of all corporations, enterprises, fund, businesses, companies, cooperatives, confederations, foundations and clubs and similar organizations provided that it is limited to the requested subject and without having to consider whether it is subject to its audit or not; within the framework of the utilization of public resources and benefits used as to the same procedure including privatization, incentives, debt and credit implementations. The clause of “Audit results are presented to the Grand National Assembly of Turkey to be evaluated.” is enacted. Non-audited areas have been formed by being excluded from the Auditor General audits either with special legal adjustments or with legal gaps formed in implementation for some funds and foundations and these restrictions to the audit authority of The Auditor General, where this created an important barrier to the execution of the objective and functions of the Auditor General as it was required. With the mentioned Additional Article to the Auditor General Law escapes from the Auditor general audit is prevented to some extent (Kesim 2005: 276).

### (c) **Ethical Principles of the Ministry of Finance Review Committee**

Ministry of Finance Review Committee has determined its ethical principles with the aim to enable the transparency in the audit duty executed and for the institutionalization of an understanding of audit based on ethical principles. The basis of the Ministry of Finance Review Committee Ethical Principles is listed in the order of accuracy, impartiality, independency, and the feeling of public responsibility. The mentioned principles are explained as the following under the headings of basic work ethics, responsibility to the society, responsibility to the profession (Koçberber 2008: 83–84).

**Basic Working Ethic:** Treasury Inspectors will perform their duties assigned to them as to the constitution and the relevant regulations considering the accuracy, impartiality independency, and justice principles in a manner to enhance public interest.

**Responsibility to the Society:** When performing their duties granted by laws, Treasury Inspectors will act in an understanding of work to gain the trust and respect of the society. Public interest will be treated above everything. With the aim to enhance the superiority of law, they will accept the provision of the execution of public services in consistency with law, provision of equality, impartiality in public services, and provision of justice as fundamental. To enhance the provision of public management resources in an effective and productive manner to be utilized for public interest, they will fulfill the audit and guidance duties granted to them deservedly. They will abstain meticulously from all kinds of behavior damaging the trust and respect vested to them in the society.

**Responsibility to the Society:** When executing their jobs, Treasury Inspectors will accept the accuracy, honesty, impartiality, and justice principles as their fundamental understanding of work with the goal to develop the profession and to protect its reputation. They will adopt supreme and excellent behavior standards. They will abstain from all kinds of behavior that may damage the respectability of the profession. They will continuously develop their professional information and accumulation. They will act in a manner that will develop the good relationships and cooperation among them. They will consider public interest above all kinds of personal benefit. They will not be under any kind of political influence.

**Responsibility to the Audited Units:** When performing their jobs, Treasury Inspectors' basic goal of the audit will be anticipated in a manner which is to assist the management in the fulfillment of transactions and activities in accordance with the law and to guide the management. They will be in complete impartiality and objectivity toward the audited institution and persons. While handling the audited topics, they will be in an impartial, objective, and scientific approach. While forming an opinion about the audited unit, all kinds of information and opinion presented by the audited unit will be taken as a base of evaluation.

**(d) Regulation about Ethical Principles to be Conformed by Independent Accountants, Independent Accountant Financial Consultants, and Certified Public Accountants in their Professional Activities**

Regulation about the ethical principles to be complied to in the professional activities of the independent accountants, independent accountant financial consultants, and certified public accountants prepared the Union of Chambers of the Independent Accountant Financial Consultants and Certified Public Accountants was published in the Official Gazette dated October 19, 2007 and No: 26675 and has taken effect. The objective of the Regulation is announced to be as: the determination of the minimum ethical principles to be complied to by the accounting profession members in their professional relationships to reach the goal of establishing a trustworthy and respectful professional group of mass of people formed of members all having the highest level of professional knowledge, social responsibility consciousness, devoted to ethical values and having an understanding of competency in a style of more qualified provision of service. Ethical principles are composed of three parts. The first part presents the basic ethical principles the profession members must comply to and the conceptual environment required for the implementation of these principles. Conceptual framework is a guidance required for the profession members to determine the threats related to compliance to principles and to take protective precautions to eliminate these threats or to reduce them to an acceptable level. The second and third parts demonstrate how the conceptual frame will be applied in particular special occasions. The second part includes the principles and cases valid for profession members working independently, and the third part include those for the ones working dependently. The fundamental principles that all profession members must comply with are organized under the headings of honesty, impartiality, professional adequacy and attentiveness, confidentiality, professional behavior (Baş and Özocak 2001: 345).

**(e) General Principals Related to Independent Audit Institutions and Their Auditors**

An important adjustment related to the ethical rules that the independent auditors will have to comply with is the “Communiqué Determining the General Principals About Independent Audit Institutions and Their Auditors with Serial No: X-3” published at the Official Gazette dated June 18, 1988 and No: 19846 which is enacted as to Article 16 of the Securities Exchange Act No. 2499 “Regulation about Independent External Audit in the Securities Market” valid for the independent audits to be performed in the Securities Market by independent institutions and auditors, determining the general principles of audit standards and professional moral principles. The ethical principles and rules that the auditors will comply to are determined in the mentioned communiqué (Dural 2002: 167–168; Güredin 2007: 113–120).

**(f) Professional Principles to be Complied by Banking Regulation and Supervision Agency Members and Banking Regulation and Supervision Agency Personnel**

Decision released as to Banking Law No. 4389 Article 3 part 5/b organizes the professional principles to be complied by the Banking Regulation and Supervision Agency Members and Supervision Agency Personnel to enhance them to perform their duties without being subject to any kind of influence or pressure, to establish the confidence in the public opinion and in financial markets that the institution fulfills duties in complete impartiality and for this confidence to be maintained. Principles published in the Official Gazette dated June 22, 2000 and No. 24087 are listed under the headings of general principles, professional principles and principles related to implementation (Yüksel Mermod 2008:505–516).

## 7.5 Conclusion

Ethics in accounting is the provision of trustworthy information to people and groups related to institutions considering the current value judgments in the society along with accounting application transactions that comply with the laws. The effect of an unethical implementation performed in accounting can spread to the whole society. It is essential that the interests of the whole society are considered during the process of accounting practices as to the social responsibility concept which is one of the basic concepts of accounting. For example, as a result of unethical behavior in the case of reflecting the financial table data unrealistically and to causing a tax evasion an effect that will spread to the whole society will be encountered.

The provision of the benefits expected from the audit profession and the derivation of trustworthy results depends on the compliance to audit standards. One of the most important aspects of the audit standards is the ethical standard. Ethical standards are one of the crucial conditions of being a profession. The core of the audit stan-

dards is constituted by the ethical principles determined by international profession organizations that have become experts in the area of audit and accounting.

Because of the importance of the ethical concept in accounting and audit, various studies have been performed both in the national and in the international levels. In the international area, International Organization of Supreme Audit Institutions (INTOSAI), International Federation of Accountants (IFAC), International Internal Auditors Institute (IIA), and American Institute of Certified Public Accountants (AICPA) have performed studies. Legal arrangements made in Turkey can be listed as such: Professional Moral Rules of Internal Public Auditors, Occasions that require disciplinary proceedings about commissioners of audits and internal regulation about the disciplinary penalties to be imposed on them, Ethical Principles of the Ministry of Finance Review Committee, Regulation about Ethical Principles to be Conformed by Independent Accountants, Independent Accountant Financial Consultants and Certified Public Accountants in their Professional Activities, General Principals Related to Independent Audit Institutions and Their Auditors, Professional Principles to be Complied by Independent Banking Regulation and Supervision Agency Members and Banking Supervision Agency Personnel.

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# Chapter 8

## Teaching Ethics in Adult Education



Ying Zheng and Yuan Lu

### 8.1 Introduction

As the essence of teaching quality, teachers' professional ethics are the main ethical principles and the code of conduct for educators to follow during educational activities, as well as reflect an educator's moral outlook, sentiment, and character. Teachers' professional ethics is an important component of an educator's professionalism and vocational training. Yan Cai, Li Pan, and Jianhua Hou (2014) used scientific literature trend visualization software, Citespace, to analyze references with the keywords "teachers' professional ethics" in the CNKI database from 2000 to 2012. They found that educational researchers were most interested in three top keywords: "devotion to students," "educational cause," and "teachers' professional ethics formation."<sup>1</sup> In the literature concerning teachers' professional ethics, most articles address general, spiritual, and foundational principles. However, there is limited research on teachers' professional ethics for special forms of education, especially on-the-job training. Hence, it is necessary to explore new central issues to contribute to the understanding of teacher's professional ethics.

Based on the authors' observation especially the 1st author's 15-year teaching experience, as a teacher of adult professionals, the author has taught over 40 thousand students, including civil servants, private sector employees, institutional staff, rural entry-level officials, vocational school students. The author has taught dozens of courses, including "Improving the Administrative Capacity of Civil Servants," "Interpretation on Labor Contract Law," "Criminal Law," "Youth Crime Preven-

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<sup>1</sup>蔡艳, 潘黎 and 侯剑华, '21 世纪以来基于科学知识图谱的教师职业道德研究热点探析' [2014](2) 辽宁医学院学报(社会科学版) 101, 104. Cai Yan; Pan Li; Hou Jianhua; Liaoning Normal University; Dalian University; 'Analysis on the Teachers' Professional Ethics Research Based on Scientometrics in the 21st Century'; Journal of Liaoning Medical University (Social Science Edition) 2014(2): 101, 104.

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tion,” “Protection of the Rights of Women and Children,” “Economic Law,” and “Rural Land Law.” During her time teaching, many students have asked her for legal advice regarding their professional or personal lives. Often times, there are practical difficulties that students face with their jobs and they regularly ask her about how to overcome these difficulties. For example, in her legal training course for law enforcement officers, some students consulted her about such issues during break time. Although it is not her obligation to give legal advice, she gave them advice in terms of both academic theory and practical application out of a sense of duty and concern. In adult education, teachers need to provide students with more than just theoretical knowledge. More crucially, teachers should be responsible to their students, have a sense of professionalism, and make their best effort in helping students achieve their goals.

The three functions of universities are to cultivate talent, develop technology, and serve society. University teachers are the main contributors of these goals. In this sense, an educator requires not only professional knowledge and skills but also dedication to their profession. As a prerequisite, they [educators] should have exceptional character, like exceptional integrity, honesty, and reputation. Moreover, educators have the duty of educating students and helping develop their character. The “Teachers’ Law of the People’s Republic of China” states, “teachers should love education as a cause, have sound ideological and moral character, have educational and teaching ability, and obtain qualifications for teachers.”<sup>2</sup> Compared with formal education, professional education at universities requires educators to initiate reforms and the construction of teaching systems, because this is a basic requirement standard of adult education. Teachers must know the governing rules of adult education and have the ability to carry out the work step by step in a well-planned way.

## 8.2 Meaning and Requirement of Teaching Ethics in Adult Education

### 8.2.1 General Requirements of Teaching Ethics in Adult Education

There are general requirements for teachers’ professional ethics in both formal education and professional education. In 1999, the State Council ratified the document,

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<sup>2</sup>“Teachers Law of the People’s Republic of China” (Article 10: The State shall institute a system of qualifications for teachers. All Chinese citizens, who abide by the Constitution and laws, take a keen interest in education, have sound ideological and moral character, possess a record of formal schooling as stipulated in this Law or have passed the national teachers’ qualification examinations, have educational and teaching ability may, after being evaluated as qualified, obtain qualifications for teachers.). <http://en.pkulaw.cn.ezproxy.soas.ac.uk/display.aspx?id=537&lib=law&SearchKeyword=&SearchCKeyword=%bd%cc%ca%a6%b7%a8> accessed 3 September 2016.

“Decision on Deepening the Education Reform and Promoting Quality-Oriented Education.”<sup>3</sup> This decision states that “teachers should take interest in the Communist Party of China, have ardent love for the socialist motherland, and devote themselves to the educational cause of the people; to establish an accurate outlook on education, quality conception, competent people, enhance the consciousness of implementation on quality education; to ceaselessly raise their ideological level and political consciousness and improve their professional competence in education and teaching, imparting knowledge and educating people, to be paragons of virtue and learning, to love students and be professional in their dedication; have a solid foundation for the professional knowledge and consciousness of requiring lifelong education, master modern technique education methods; follow education principles, be positive in education research, encourage to make exploration and innovation; keep relationships with students equally, respect their dignity, teach students on the basis of their aptitude, protect the legitimate rights and interests of the students”.<sup>4</sup> Combining the decision with “the Marxism and Ideological and Political Education courses”<sup>5</sup> (Jiao Ren [2011] No. 11), there are six tenets of teachers’ professional ethics: patriotism and observance of the law, love of students and professional dedication, educating students and developing their character, rigorous scholarship, to serve society, and to be role models of virtue and learning.

In respect to theoretical research, Chinese scholars have a similar understanding of teachers’ professional ethics. Many scholars believe that the requirements of teachers’ ethics are to love students, be responsible, and have a spirit of professional dedication. However, some scholars support a newer understanding of this concept. For example, Hui Wang believes that the current understanding of the requirements for teachers’ professional ethics are deficient because they tend to be idealistic and without systematic, adaptive (can encompass a lot), or hierarchical (different specifications for different levels of seniority) theories. This has led to a slow improvement in teachers’ professional ethics and has resulted in much criticism on the present understanding of the topic.<sup>6</sup> Nevertheless, Bei-fang Xiao notes, “it is necessary for teachers to encourage students to become self-conscious and self-driven during their interactions. Teachers should discover and use a variety of opportunities to improve

<sup>3</sup>“中共中央国务院关于深化教育改革全面推进素质教育的决定”, “Decision on Deepening the Education Reform and Promoting Quality-Oriented Education.” <http://www.chinalawedu.com/news/1200/22598/22615/22793/2006/3/he7396032197360029150-0.htm> accessed 13 March 2017.

<sup>4</sup>Ibid.

<sup>5</sup>“《高等学校教师职业道德规范》印发 - 中华人民共和国教育部政府门户网站”, “Notice of issuing the ‘the Marxism and Ideological and Political Education courses’-website of Ministry of Education of the People’s Republic of China.” [http://www.moe.edu.cn/s78/A04/moe\\_693/s8052/201201/t20120110\\_168674.html](http://www.moe.edu.cn/s78/A04/moe_693/s8052/201201/t20120110_168674.html) accessed 13 March 2017.

<sup>6</sup>王慧, ‘对教师职业道德要求几个误区的批判’[2008] 当代教育科学(8) 15–16. Hui Wang, “criticism on misunderstanding requirement of teachers’ professional ethic”. Contemporary educational science.

their professionalism constantly and this is beneficial for teachers to accomplish and improve their own value.”<sup>7</sup>

### **8.2.1.1 Specific Requirement of the Teaching Ethic in Adult Education**

Adult education is different from formal education. For example, adult education is characterized by short duration, diverse teaching methods, and widely different students. Moreover, students are highly experienced and require teachers with advanced professional knowledge. Thus, teachers should teach students according to their aptitudes, and therefore, adult professional education demands more specific requirements.

#### ***Emphasize practical results with a sense of responsibility***

Adult education must have an objective and must be practical and clear, instead of losing sight of reality, because it must meet the students’ professional needs. Teachers should focus their educational efforts on improving their students’ working professional abilities. Compared with formal education, professional education requires teachers to initiate reforms and to build responsible system. As a reason of that, students who attend adult education would expect useful skills in their work in future. This makes adult educational teachers have responsibility to guide students to learn both academic knowledge and practical skills. This is also the characteristic and norm of adult professional education. This is also a demand for teachers dealing with highly talented students in professional education. Thus, teachers in professional education must know the principles, rules, and norms of teaching adults and they also need the skills to cover each stage of this process.

#### ***Flexibility and diverse adaptability***

The student body of adult education is diverse in terms of origin, background, and motivation. Thus, teachers of adult education must adapt to construct diverse teaching systems during on-the-job training based on the students and their differences. Accordingly, teachers should consider more about their students, namely their individual backgrounds and needs. Moreover, teachers should be able to build their professional knowledge and abilities toward a defined goal. This is the reason why teachers should be adaptable to their students’ characteristics and considerate of their needs. At the same time, teachers should develop a good habit of adjusting their educational methods or systems based on what their students require.

#### ***Keep an equal profile and be approachable***

Adult education students have either completed formal schooling or have professional experience, or both. Generally, they are mature and experienced middle-aged

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<sup>7</sup>肖北方, ‘发展——教师职业道德的新主题’ [2007] 北京教育:普教版(5) 41. Bei-fang Xiao, “Development—new perspective of teachers’ professional ethic” Beijing Education (General Version).

individuals. They tend to have conversations with teachers equally. Teachers should be strict with students and, at the same time, refrain from condescension and be humble in order to maintain a healthy relationship. This is an efficient form of communication that proves effective and beneficial in transferring knowledge from teacher to student. One training course that the 1st author taught was a special course for people who made mistakes at work. Most of the students in this course felt strongly that they were treated unfairly. They were also quite rebellious and became depressed easily. This class took much more hard work, energy, compassion, and patience than usual. Once, when a student in this class felt unwell, the author took him to the hospital for treatment and lent him some money without giving it a second thought. The author even checked up on him throughout, causing the student to change his attitude. After this, the students in this course seemed to become much more positive and less difficult, leading to less complaining and an overall better class.

### ***Realistic and productive implementation***

Teaching ethics require realistic implementation methods in order to be implemented effectively. To some extent, teachers can try to teach students in a different way, which is beyond the textbook, and lead students to practice the knowledge they have already known, as long as they have the ability to combine theory with practice effectively. Firstly, they need the ability to dig and collect resources. They require the ability to gather large amounts of useful information via the Internet and the ability to build a unique and professional group of resources. Secondly, they need to master their skills as an educator. They must know about science, regular teaching methods and means, modern and advanced technology, and possess knowledge about the professional world in order to improve the quality of the education they provide. Thirdly, teachers need a solid foundation of teaching and the capability to perform research. It is extremely important to train teachers in modern education theory, modern vocational studies, and professional education. In order to improve the quality of a teacher, it is vital they are adept at academic research, science, and that they have teaching experience.

#### **8.2.1.2 The Building of Teaching Morals in Adult Education**

There are three functions of teachers' professional morals, which are guidance function, reorganization and consolidation function, and encouragement function. The main function is the guidance function, which is leading the direction of teachers' professional ethical activities. Building the teaching morals helps teachers improve their professional educational undertakings. It is also helpful for college managers in running the college because teachers can follow the standard rules easily and consciously. Additionally, it is important that teachers keep their behavior within the bounds of discipline, which is done by implementing teachers' professional moral standards and school rules. Another main function is the reorganization and consolidation function, which is the adjusting of teachers' actions in order to make teachers united and cooperative under a unified leadership. Yet another function is

the encouragement function, which is the establishing of teachers' lofty ideals and setting great models by building a system of regulations concerning rewards and disciplinary sanctions. The significance of the role of teaching ethics depends on the position of the teacher in the society and the characteristics of professional educational efforts. Several educational workers and scholars have researched about the structure of teachers' professional ethics from different perspectives. Hong Yu thinks that to fulfill the task of constructing modern teaching ethics, we must update our conception of the "Four Teaching Exemplary Roles," which are portraying the model image of a great teacher, fostering a good respectful teacher image, being qualified as a teacher with first-rate professional abilities and superb teaching skills, and creating environments for teaching ethics development. The system of safeguarding the modern construction of teaching ethics would be established through six elements: management, assessment, self-discipline, study, supervision, theory.<sup>8</sup> Because on-the-job training has its own characteristics in terms of teaching mission, teaching content, and teaching objective, the construction of teachers' professional ethics has more requirements, especially on deeper content and more functions of teaching ethics. Depending on foreign and domestic ethics research results from scholars and educators, the maneuverability of the construction of teaching ethics can be further clarified into three gradations: ideal, principle, and rule constructions.

#### ***Teaching profession moral ideals construction***

Moral ideals are the encouraging function with the highest realm of thought. The teaching profession's ethics ideals are the strictest requirement for teachers. The contents of moral ideals include loving education as a cause, dedication, and spirit, pursuing the truth, being true to facts, aiming for high levels of specialization, maintaining a high standard model of ethic and conduct, etc. In order to achieve the result of a moral ideals construction of the teaching profession, it is necessary to strengthen a sense of responsibility so that the teacher can increase their awareness of the affect they can have and so that they can learn to work closely with students and their qualifications to help them secure a job in the future. This causes the teacher to shift their focus of teaching toward education beyond textbooks and to treat the teaching profession as just one element among the whole of education circles. Thus, the teacher has an enhanced sense of the importance of their job and of the achievements that come to be because of their efforts. In the 1st author's school, most on-the-job training courses have ice-breaking and outward bound lessons. Teachers also get involved in these courses with trainers. Teachers count it as personal favor when they train together, and this contributes to a better understanding of students' situations and needs. Additionally, it is beneficial for teachers to identify with students and to have clearly defined goals that eventually bring about results.

#### ***Teaching profession moral principles construction***

Teachers' profession moral principles is an intermediate requirement for teachers' professional code of conduct and which all teachers must meet. Qing-feng Wang

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<sup>8</sup>于红, '新时期师德建设浅探' [2008] 江苏高教(2): 96-97. Hong Yu, 'Research about teaching ethic construction in the new era.' 2008, Jiangsu Higher Education, (2) 96-97.

believes that teacher's professional ethics education needs to manifest itself through daily education and variety teaching activities. These principles emphasize the significant role of developing the teacher's ability of implementing teaching ethics. Also, they should be based on the teacher and the personalities of students.<sup>9</sup> Students in on-the-job training courses have the characteristics of sensitiveness, affinity to students during conversation, and action of enhancing practical teaching ability. These characteristics can be classified in the category of profession ethic principles. In order to become a qualified on-the-job training teacher, one should become confident in their understanding of the characteristics of different students and communicate with students in a smooth manner, as well as provide both useful theoretical and practical guidance to students for their particular job requirements. Teachers should also meet the requirements that a school demands. As far as meeting those requirements, there are several, specific methods and means. For example, there are junior civil servants training courses in our curriculum. The teachers in this course must attach a sense of importance that cultivates a working ethic worthy of the position. The school has nine main curricula: political aptitude, administrative capacity, public service ability, investigative and research skills, ability to learn, communication and coordination ability, innovation, ability to respond to emergencies, emotional intelligence. The school also has established a civil service etiquette course in order to help young people adjust to the specific needs of civil service positions.

### ***Teaching profession moral rules construction***

The teaching profession's moral rules are the basic, or minimum, requirements for teachers' professional code of conduct and they are the basic standards that a teacher must follow. This is also called the basic rules of teaching ethics. The teaching ethics rule plays a restraint role in teachers' professional conduct through clear rules that are easy to follow and cannot be easily bent or misinterpreted. The ethics rule is often the most important key and the biggest part of any kind of professional ethics.

Professional ethical rules serve to outline the wrongs and describe the behaviors that constitute a violation. These undesirable conducts include lack of preparation for lectures, truancy, canceling the course easily, lack of enthusiasm, using words irresponsibly during class, remark students' grade, depreciating students' personalities, discrimination, resorting to deception in researching, unreasonable intervention in others' professional behaviors, slovenliness, vulgarity. Teachers doing on-the-job training at Chinese schools should adhere to additional rules due to the special nature of adult education. These other professional ethical rules include: no taking advantage of a teacher's position and power to use a student's working background, no exposing of a student's performance to the work unit in order to show reproach, no suppression of the expression of personal experience, no generalized responses to student's specific questions, etc. Once, at the 1st author's school during the evaluation of student's thesis through correspondence education, one supervisor abused his power

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<sup>9</sup>王清风, '加强和改进教师职业道德建设的对策' [2008] 河北农业大学学报(农林教育版) (1): 38-39, 39. Qingfeng Wang, 'The strategy of strengthening and improving the construction of teacher's professional ethics' Journal of Agricultural University of Hebei (Agriculture and Forestry Education Edition), 2008, (1): 39.



for personal gain. He demanded a voucher for giving the student a passing grade, and this incident was reported by a student. Because of his violation of teaching ethic rules, the school took disciplinary action against the teacher and disqualified him as a supervisor. The school also circulated a letter of criticism and ordered him to return his illegal stuff. Another example yet is a teacher who gave a lecture in a training course to the mid-ranking government officials. He made unwarranted claims of a provincial level cadre's name unreasonably and without any lawful information. He was punished through a prohibition on teaching for three years, and because he was a suspect of slander, the relative judiciary was involved for the investigation.

### **8.3 The Problems and Constructive Opinions on Improving Teaching Ethics in Adult Education: The Analysis of Problems and Reasons**

#### *Shaking of Teachers' faith in the profession*

Some teachers are not firm in their belief of the ideals of Chinese socialism and sometimes easily forget to cherish their post and to devote themselves wholeheartedly to their work. This leads to a shaking of their faith in the profession.

The profession of teaching has characteristics that are hard to quantify, such as how much effort is being put in by teachers. It is also difficult to supervise the quality of a teacher's work. This is the reason why teachers require a strong sense of responsibility and professional ethic. However, if a teacher has strong ideals and a firm belief in Chinese socialism, they all but guarantee that their hard work will bear fruit and that they will achieve great things. This is if a teacher keeps communist ideology as their base for professional ethics. However, we cannot be optimistic with the current situation of adult education in China. Some teachers have not promoted understanding about China's current conditions and have not attached great importance to teaching ethics or knowledge of their profession. It is obvious that the majority of teachers are only focusing on academic theories instead of national news about society, law, or the economy. In other words, teachers should not concentrate on books and ignore the importance of updating their knowledge. Some teachers become distracted by concerning themselves with their incomes, treatment, professional titles, rewards, and personal reputations. They make a superficial inspection and muddle through their work without cherishing the post and devoting themselves wholeheartedly to work. Compared with youth education, students attending adult education courses are more concerned with how to make their education utilitarian and how to achieve useful advantage is the only motivation for them to study. This leads to a difference between the original intent or direction of education and the reality of adult education. There is a disadvantage to this situation, which is that teachers' dreams are trending to utility and teachers are seeking more personal gain instead of contributing to the teaching profession's highest ideals.

There are three reasons for the problem mentioned above. First, teachers are lacking political consciousness and the school of their on-job-training did not provide enough tools or exposure on political topics. Having faith in politics brings values that help society make right. Having these values helps one fulfill their obligations and practice what they preach. Nowadays, the emphasis on educational revolution is in the fostering of one's professional ability and academic knowledge. To some extent, this is not beneficial to the construction of teachers' ethics. Second, there are some kinds of training, but these kinds of training for teachers are limited by formalism without specific details. The training only includes consciousness of ethics, but that is not enough for teachers' requirements. There should be more than surface training. For example, the teacher ethic is a conception which requires teachers to know how to portray the image of consciousness of teaching profession ethics. Additionally, it also requires the ability to differentiate and analyze conceptions of ethics, to make accurate choices, and to train in morality construction. All these professional ethics training styles have more meaning than shallow, surface training like knowing the conception of teaching ethic. Thus, the current teacher training style neglects the importance of teachers' betterment or the building of teachers' world views and values.<sup>10</sup> Third, the negative aspects of cyber culture bring disadvantages. Media found online has a lot of diverse and differing information that is poorly regulated. A lot of information online is spread widely regardless of whether or not it is factual. Unethical street culture and entertainment, as well as vulgar words and inappropriate media, is found on the Internet. If teachers begin to accept faulty information, the effects are unpredictable, and it is inevitable that this corrupted information will influence people's minds in a negative manner. Most troubling is that the current culture found online tends to encourage people to overemphasize individualism and ego-centrism. This kind of culture is incompatible with the traditional ideology, which emphasizes dedication toward one's own career until successful. The downside of cyber culture is that it forces teachers to give up their loyalties to the teaching profession and results in less dedication given to their professionalism.

***The value orientation of life is distorted, and the tendency toward utilitarianism is more prevalent. Teachers lack self-discipline***

Nowadays, some teachers of adult education are different in their attitudes toward the value of teaching. Teachers are becoming more and more preoccupied with matters of efficiency instead of emphasizing their mastery of the curriculum and pedagogical techniques. Individualism and ego-centrism should not be practiced by teachers, and the attitude of utilitarianism should not even be considered by teachers either. In practice, some teachers express egotism and act selfishly. This is definitely not beneficial to their ethic. This paper does not hold a unanimous opinion of these teach-

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<sup>10</sup>曹小杰, “高校师德建设中的影响因素及对策分析” [2017]-01 西部素质教育 272. Xiaojie Cao, “the elements and measures on construction of teachers' ethic”, 2017(01) Western China Quality Education. Page 272. [http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=XBSJ201701207&DbName=CJFD2017&DbCode=CJFD&uid=WEEvREcwSIJHSlRdRlFhb09jMjQwWUdIdmhJM2c5Z3d5a3RXeHJkdWpzTT0=\\$9A4hF\\_YAuvQ5obgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!](http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=XBSJ201701207&DbName=CJFD2017&DbCode=CJFD&uid=WEEvREcwSIJHSlRdRlFhb09jMjQwWUdIdmhJM2c5Z3d5a3RXeHJkdWpzTT0=$9A4hF_YAuvQ5obgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!)

ers' expression. However, some teachers treat their jobs as just a form of income. Teachers are educators and have a significant role in shaping future society. They must consider how much of an effect their actions have, and thus, it is detrimental if they cannot devote themselves to their work. It is necessary for teachers to practice what they preach. Adult education is different because the students have working experience, and some of them have extraordinary titles, which leads to some teachers focusing too much on social status. Teachers that try to utilize these interactions for personal gain are being irresponsible and breaking the ethics of their profession. Some of them even accept gifts from their students or other benefits. Adult education creates a hotbed for possible corruption and exploitation by teachers. Some teachers fail to do their duties as educators because they are blinded by personal gain opportunities and see their profession as just a part time endeavor. For instance, some teachers force students to buy their books so that they can make money. The behavior of such teachers not only damages the image of an educator to students but also make the educator seem morally corrupt. This is against teaching ethics.

Three reasons could explain why some teachers act against their profession ethics. Firstly, with the current conditions of the market economy, some influential ideologies have emerged. For example, people are more money-minded and hedonism is widely spread. This social conduct makes people lose their principles and become more utilitarian. These negative conceptions impact people's thoughts constantly, including teachers. Secondly, with the development of the market economy, teachers have a lot of pressure in their daily lives, like housing problems, income problems, children education problems, and various other challenges. Some teachers encounter a variety of difficulties when they face reality and they might bring negative emotions to work. Teachers tend to choose to damage their profession ethics for personal interest as a solution to personal difficulties. Thirdly, the amount of funding that the government provides to education is too low compared to other programs and social services. Teachers demand more and more, and if the government does not provide adequate assistance, teachers will simply find a way to get by and survive.

***The emergence of job burnout and ignorance of profession ethics make teacher passive in enhancing their cultivation of teaching morals***

Teaching and academic research are the main tasks for adult education teachers. These two aspects promote and improve each other. However, the majority of teachers pay more attention to academic research than to teaching, currently, and few of them put enough unilateral effort on academic research. Teachers are losing their passion for teaching little by little, and job burnout eventually sets in. Some teachers become satisfied with their current abilities and become apathetic toward improving themselves. Even more, some teachers lose enthusiasm and become insincere and indifferent with their students. They behave impolitely without concern for their students. Instead, they show disrespect toward students, like discrimination against new students or teasing of the weak. This hurts the pride of students and is against the ethics of the teaching profession.

This paragraph will introduce three reasons why this phenomenon happens. Firstly, teachers who have few academic achievements are in a disadvantageous

position on salary, title, treatment, and promotion, because the “Golden Rule” of university or college is “Academia is much more important than teaching.” Universities have quotas that are too high. These factors lead teachers without enough academic achievements to decrease their satisfaction with their profession and to lose some sense of honor. This leads some teachers to only treat the teaching profession as a tool for survival instead of as a passion. Many teachers believe that the value of the teaching profession is in great academic research and that this would prove all their value and sense of achievement.<sup>11</sup> Secondly, regarding education’s system of performance assessment, the phenomenon of “teachers’ own business is more important than teaching students” is widespread, no matter regarding annual assessment, job title evaluation, or performance assessment. Most educational systems only attach importance to results and ignore the details of teaching and teaching methods. This makes some teachers just focus on the results and care less about a student’s ideology cultivation, paying no attention to self-discipline and the cultivation of morality. Thirdly, the education system in China lacks effective and proper mechanism for supervision. This causes teachers to have less opportunities to improve their professional teaching abilities. The assessment criteria of teaching ethics in college are not enough and incomplete, so the level of political awareness and conduct among teachers is out of control. The basic requirements for teachers are that they should observe the law and disciplines and have dedication toward their profession. However, these requirements are too basic and they lack details. This mechanism is inflexible and ineffective, which leads to an unbalanced development of teachers’ thoughts without any consideration of the improvement of teaching ethics.

## 8.4 Constructive Suggestions and Analysis of Strengthening Teaching Ethics

### 8.4.1 *Combining Teaching with Self-education and Strengthening Teaching Ethics in Adult Education*

First of all, adult education teachers should cultivate the concept of lifelong learning and strengthen the motivation to constantly improve in their students. This applies to not only academic knowledge but also political theory. Adult education teachers should also enrich ethics and morality, so that they can help students value their role in politics. This is how teachers can contribute to the future of China. Next, it is important that universities promote the cultivation of teaching ethics. For example, theme projects and activities on teaching ethics can be implemented regularly and be based on the teacher’s requirements and political demands. One suggestion is that

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<sup>11</sup> 刘琼, ‘浅谈高校青年教师思想道德建设’ [2017]-03 教育教学论坛 31. Qiong-Liu, ‘An Analysis of Ideological Morality of Young Teachers in Colleges and Universities’, 2017(03) Education teaching Forum. Page 31. <http://oversea.cnki.net/kcms/detail/detail.aspx?recid=&FileName=JYJU201703015&DbName=CJFD2017&DbCode=CJFD>.

a school could list relevant activities, such as “Proposal for school,” “My students,” “My teachers” on Teachers’ Day. This would be beneficial in that it would strengthen the confidence and sense of responsibility in teachers. The school could also have an activity named, “Alleviation of junior teacher’s stress” where teachers can share the pressures and difficulties they face in their lives. One more thing still, schools should formulate policy dealing with the training of junior teachers that helps them improve their abilities on their way to becoming qualified teachers. This should be a systematic kind of training where they learn the ethics, skills, and abilities required for working as a teacher.

#### ***8.4.2 Direction of Public Opinion and an Assessment System Should Develop Simultaneously, and Improve the Construction of Teaching Ethics***

Firstly, to improve the assessment system of teaching ethics is important. Schools need to formulate appropriate principles and rules on teaching ethics, as well as an assessment system for admission criteria. An assessment system involves not only teachers’ academic research and teaching contents but also establishing a mechanism of regulations concerning rewards and disciplinary actions. This would be helpful for exploring a new system of supervision, which could reorganize and consolidate the various resources and powers of a society. In regard to the minority of teachers who are morally corrupted, schools should punish them through criticism and lectures on educational standards. Should they violate the rules seriously, then it might be necessary to expel them from school. Secondly, it is important to establish a system of public opinion direction. Nowadays, it is of paramount importance to know how to strengthen the confidence of teachers’ ideals and to avoid the negative effects modern sources of information can have on teachers and their ethics. Colleges and universities should establish and promote a new media management system and create clear rules, rules that make clear the “red line” that prohibits certain kinds of behavior and set the standard on how teachers are to behave on the Internet. Meanwhile, establishing a channel for complaints and the sharing of information on the construction of teaching ethics are important, as it would encourage students to participate passionately and enthusiastically. It is also beneficial for universities to supervise teachers’ ideological styles, as a proper supervision system for teachers’ ethics helps maintain a healthy standard across the board.<sup>12</sup>

#### **Complying with the principles of adult education and making professional ethics play a functioning role in practice**

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<sup>12</sup>蔡信强, 新媒体时代高校青年教师师德建设常态化研究, 中国培训. 2017-09. Zhan-ying Jin. “Research on the Normalization of Teacher’s Professional Ethics Construction in the New Media Era” 2017(09), China Training.

The traditional Chinese teaching method of ethical education is spoon-feeding students, however ineffective it is. It is much more useful to implement a new method involving “self-consciousness” and “self-improvement,” as this method is more suitable with modern educational standards. This method includes several parts such as building practice platforms in and outside university. It would help increase the awareness of teaching ethics, value cultivation and independent thinking, and help contribute to society’s well-being. Firstly, in regard to universities, professional monitors, professional organized tutors, and competitive group tutors all play important roles in specialized professional skill training courses. These individuals would help future teachers improve themselves on the construction of ideals and on professional ability. Teachers also need to learn the conscious of serving for students. Secondly, outside the university, teachers should go among the masses to observe and learn from real life. This is one type of practical activities, and it can encourage teachers to participate the activities as volunteers enthusiastically, and currently, this is the main task of political education for young college teachers. Teachers would learn value of dedication and selflessness to improve their characters and mental outlooks. For example, the internship training project in Hebei Normal University arranges young teachers to experience country life while receiving basic education there. Teachers are the ones who propagate the doctrine, impart professional knowledge, and resolve doubts. They also learn the intention of education-related ethics and achieve personal value appreciation and social value unification.<sup>13</sup>

## 8.5 Conclusion

This paper introduces the concept of teaching ethics as well as reiterates that it is important for colleges to improve their quality of teachers. In explaining the meaning and needs of “teaching ethics” in adult education, this paper provides specific and general requirements for teachers. The paper also introduces the meaning requirement of teaching ethics in adult education with specific requirement. It also explores the construction of moral ideals, moral principles, and moral rules and helps expound the problems in current adult education while providing workable suggestions for improving teaching ethics. This paper does not cover all the topics due to the space, but the authors would like to bring the topic to the both academic practicing circles for reference.

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<sup>13</sup> 闫东利, ‘高校青年教师思想教育的困境与突破’ [2017]-01中国领导科学 21. Dong-Li Yan, “Difficulty and Breakthrough on Political Education of Young College Teachers”, 2017(01), China Leadership Science, page 21. [http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=KXLD201701013&DbName=CJFD2017&DbCode=CJFD&uid=WEEvREcwSlJHSldRa1Fhb09jMjQwWUdCQmkyRkZ1cVJDTjJ3RGp5aWphST0=\\$9A4hF\\_YAUvQ50bgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!](http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=KXLD201701013&DbName=CJFD2017&DbCode=CJFD&uid=WEEvREcwSlJHSldRa1Fhb09jMjQwWUdCQmkyRkZ1cVJDTjJ3RGp5aWphST0=$9A4hF_YAUvQ50bgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!)

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# Chapter 9

## Conflicts of Interest and Improvement Measures in Lawyers' Practice



Hong-you Sun and Yuan Lu

### 9.1 Introduction

The All China Lawyers' Association verified the document "Code of Conduct for Lawyers (for Trial Implementation)" on March 20, 2004, and the amendment was clarified by changing the definition of lawyer's conflict of interest, which is written in Article 76 "The conflict of interest shall refer to the conflict in the interests between the entrusted matters of the same law firm and the clients of other entrusted matters of the firm, which may directly influence the interests of relevant clients if the firm continues to act as an agent to represent the client."<sup>1</sup> However, Bao-hong Li, a Chinese scholar, believes that this definition lacks precision and is limited to the systemic level, excluding specifics.<sup>2</sup> Another Chinese scholar, Xiang-yu Huang, also thinks that this

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<sup>1</sup>"Notice of the All China Lawyers' Association on Issuing the Code of Conduct for Practicing Lawyers' (2011 Revision)" <http://en.pkulaw.cn.ezproxy.soas.ac.uk/Display.aspx?lib=law&Cgid=163990> accessed 22 October 2016.

<sup>2</sup>李宝宏, "论律师执业利益冲突及其规制" (硕士, 西南政法大学 2009) Bao-hong Li, "Conflicts of Interest and Regulations in Lawyers' Practice" 2009(10), Southwest University of Political Science & Law. <http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=2009121588.nh&DbName=CMFD2009&DbCode=CMFD> accessed 22 October 2016.

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definition is limited.<sup>3</sup> The definition was also criticized by Jun-wei Li as vague and general.<sup>4</sup> In contrast, in America it is clarified with further details in terms of defining conflict of interest in lawyers' practice. Article 121 in the Restatement of the Law Governing Lawyers of the American Bar Association stipulates that "there is no conflict of interest ... unless there is a 'substantial risk' that a material adverse effect will occur... The standard requires more than a mere possibility of adverse effect." Statements on lawyer's conflict of interest are addressed more specifically and more completely in the UK when compared with China's. The UK also addressed many stipulations with narrower definition in terms, to avoid covering too large a scope or creating misunderstandings. For example, the Code of Conduct 2007 on Solicitors Regulation Authority has addressed the conflict of interest issue in Rule 3. Rule 3 defines this as follows: "(a) you owe, or your firm owes, separate duties to act in the best interests of two or more clients in relation to the same or related matters, and those duties conflict, or there is a significant risk that those duties may conflict; or (b) your duty to act in the best interests of any client in relation to a matter conflicts, or there is a significant risk that it may conflict, with your own interests in relation to that or a related matter."<sup>5</sup> However, Rule 3 of the Code of Conduct was amended on 31 March 2009 as part of a general updating of the rules to introduce firm-based regulation and legal disciplinary practices as provided for in the Legal Services Act 2007.<sup>6</sup> Although the rule 3 has been amended, the spirit of conflict of interest still influences law makers when they draft new stipulations on this topic today. Hong Kong has different rules on conflict of interest. There are direct conflicts and indirect conflicts between lawyers and their clients in "Hong Kong Bar Association's Code of Conduct." Direct conflict is described as visible and clear collision of interests which were exposed in the relationship between clients and their lawyers. Indirect conflict is potential collision of interests which might be exposed lawyers' professional conduct in future. In terms of understanding the different countries' interpretations of the conflict of interest' rules,

<sup>3</sup>黄翔宇, "我国律师执业的利益冲突规则—对我国现行制度的分析", 2011-04, 黑龙江省政法管理干部学院学报. Xiang-yu Huang, "The Conflict of Interest Rule of Legal Service Practice in China", 2011(04) Journal of Heilongjiang Administrative Cadre College of Politics and Law, Editorial E-mail. [http://xueshu.baidu.com/s?wd=paperuri%3A%289c3ec2361b33e07c4c75fca564291c41%29&filter=sc\\_long\\_sign&tn=SE\\_xueshusource\\_2kduw22v&sc\\_vurl=http%3A%2F%2Fd.wanfangdata.com.cn%2FPeriodical%2Fhljszfglgbyxb201104004&ie=utf-8&sc\\_us=17683391525488750731](http://xueshu.baidu.com/s?wd=paperuri%3A%289c3ec2361b33e07c4c75fca564291c41%29&filter=sc_long_sign&tn=SE_xueshusource_2kduw22v&sc_vurl=http%3A%2F%2Fd.wanfangdata.com.cn%2FPeriodical%2Fhljszfglgbyxb201104004&ie=utf-8&sc_us=17683391525488750731) accessed 22 October 2016.

<sup>4</sup>李军伟, "论律师执业中的利益冲突" (苏州大学 2012). Jun-wei Li, "Conflicts of Interest in Lawyers' Practice" Suzhou University, 2012(10).

<sup>5</sup>Cited by 王琳, "简论我国律师执业利益冲突的原则, 规则与规制" (硕士, 中国政法大学 2011) Lin Wang, "Analysis of lawyers' conflicts of principles, rules and regulations" SuZhou University, 2011(09), Master Degree. page 3. [http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=1011114731.nh&DbName=CMFD2011&DbCode=CMFD&uid=WEEvREcwSIJHSIdRa1Fhb09jMjQwT2p0ZWVjMHQvcFIFMDNzSORHZEMwTT0=\\$9A4hf\\_YAuvQ5obgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!](http://oversea.cnki.net.ezproxy.soas.ac.uk/kcms/detail/detail.aspx?recid=&FileName=1011114731.nh&DbName=CMFD2011&DbCode=CMFD&uid=WEEvREcwSIJHSIdRa1Fhb09jMjQwT2p0ZWVjMHQvcFIFMDNzSORHZEMwTT0=$9A4hf_YAuvQ5obgVAqNKPCYcEjKensW4ggI8Fm4gTkoUKaID8j8gFw!!) accessed 2 February 2017. "Change Tracker—Code of Conduct" <http://www.sra.org.uk/solicitors/change-tracker/code-of-conduct/rule3.page> accessed 6 February 2017.

<sup>6</sup>"ukpga\_20070029\_en.pdf" [http://www.legislation.gov.uk/ukpga/2007/29/pdfs/ukpga\\_20070029\\_en.pdf](http://www.legislation.gov.uk/ukpga/2007/29/pdfs/ukpga_20070029_en.pdf) accessed 7 February 2017.

it is not difficult to see that China has made its rules too general on this issue. China has much to learn from other countries on clarifying and improving the definition of conflict of interest. With fast development and changes in China, there is an increasing variety of legal disputes. Thus, the issue of lawyer's conflict of interest is becoming more significant. We need to attach importance to conflict of interest due to its characteristics. In Western countries with developed economies and legal systems, relevant laws were drawn up based on full attention to conflicts of interest, and this is because conflicts of interest are a widespread and intense phenomenon. Furthermore, as far as one may consider the characteristics of complexities and contradictions in this issue, there are major relevant arguments discussing how to prevent and resolve conflicts of interest, raised by academic and practice circles. Among them, one scholar supports the view that the key point in resolving the conflict of interest problem is to draw up precautionary rules. And these rules should give lawyers and each party substantial freedom because the indirect conflict of interest is complex.<sup>7</sup> Some scholars believe that the most effective solution to conflicts of interest is checking and balancing of the internal and external factors.<sup>8</sup> The internal factor means that lawyers would believe in and be devoted to the reputation of their career. The external factor comes from the regulation of lawyers' associations, clients' supervision, and public opinion. In addition, some scholars believe that China should learn from America on how to resolve conflicts of interest. The law in America leaves some leeway for lawyers when they represent conflict of interest cases.<sup>9</sup> It takes into account how much clients cost on lawyers' fee, how much reasonable interest clients expect, and it also accounts for the influence on the reputation of the law firm. Another scholar points out that China needs to treat conflicts of interest more seriously and this would force Chinese lawmakers to formulate rules with additional specifications and more details.<sup>10</sup> Furthermore, some scholars take the view that the key point is "Lawyers' Law of the People's Republic of China" because this law stipulates an inaccurate definition of conflict of interest, and it is too broad.<sup>11</sup> For example, there are too many law-making

<sup>7</sup>黄翔宇, "我国律师执业的利益冲突规则——对我国现行制度的分析" [2011] 黑龙江省政法管理干部学院学报 11. Huang Xiang-yu, "The Conflict of Interest Rule of Legal Service Practice in China," *Journal of Heilongjiang Administrative Cadre College of Politics And Law*, 2011(04).

<sup>8</sup>王, "简论我国律师执业利益冲突的原则、规则与规制" (n. 5). (硕士, 中国政法大学 2011) Lin Wang, "Analysis of lawyers' conflicts of principles, rules and regulations" SuZhou University, 2011(09), Master Degree.

<sup>9</sup>陈超, "论我国的律师利益冲突规则" [2009]-11 法治与社会 (Legal System And Society). 68页 Chen-Chao, "The Theory of China's Lawyer Conflict of interest rules," *Legal System And Society* 2009(11). Page 68.

<sup>10</sup>龙世发, "律师执业利益冲突规则研究——基于中美法学教材的比较" [2011]-9 法治与社会 (Legal System And Society) 283页. Long-Shifa, "A Lawyer's practice research-Conflict of Interest Rules based on the Comparison of America Textbook and Chinese one," *Legal System and Society*, 2011(09), page 283.

<sup>11</sup>李军伟, "论律师执业中的利益冲突" (硕士, 苏州大学 2012) LI Jun-wei, "Conflict of Interest in Lawyers' Practice." Master Degree, Suzhou University, 2012(10). <http://oversea.cnki.net/kcms/detail/detail.aspx?recid=&FileName=1012388512.nh&DbName=CMFD2012&DbCode=CMFD> accessed 10 February 2017.

departments writing definitions of conflict of interest, and the whole legal system is in a confusing state; it is not easy for lawyers to apply so many laws at the same time. Even the departments have stipulated rules on conflict of interest, which are difficult for lawyers or clients to follow.<sup>12</sup> This paper would support that the characteristics of conflict of interest in China are complexity and relevant opinions. This paper will organize and analyze scholars' suggestions on how to standardize lawyers' service when they face conflict of interest in China. Furthermore, this paper will explain the main reason why China has an unclear legal system in regard to lawyer's conflict of interest. The current situation is like this: firstly, lawyers cannot figure out their roles during legal service; secondly, there are few legal mechanisms which could maintain a healthy legal system; thirdly, the Lawyers' Association cannot play a significant role, and it has little power of autonomy. This paper will be divided into four parts. The first part will introduce the definition of conflict of interest. The second part will expound new opinions on the current legal system and problems regarding conflict of interest in China. The third part will describe the relevant rules on this issue in America and the UK. The fourth part will give some suggestions for China to improve and formulate relevant rules on conflict of interest. The last part will predict and give a full view of the trend on lawyer's conflict of interest in China.

## 9.2 The Current Situation and Problems Regarding Lawyer's Conflict of Interest

### 9.2.1 Regulation: Multiples of Lawmakers Result in Disorder

#### Multiples of lawmakers

As discussed above, the conflict of interest is codified in Lawyers' Law of the People's Republic of China (2007 Revision)<sup>13</sup> and the interpretation of the Supreme People's Court.<sup>14</sup> There are similar or identical guidelines for lawyer's conflict of interest in both "Administrative Measures for the Practice of Law by Lawyers (2016 Revision)"<sup>15</sup> and Lawyers' Law in China. Meanwhile, both "Code of Conduct for

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<sup>12</sup>Ibid.

<sup>13</sup>"Lawyers' Law of the People's Republic of China (2007 Revision)" <http://en.pkulaw.cn/display.aspx?id=6463&lib=law&SearchKeyword=&SearchCKeyword=%c2%c9%ca%a6%b7%a8> accessed 12 February 2017.

<sup>14</sup>"Notice of the Supreme People's Court on Issuing Several Provisions on the Implementation of Clean Government Norms by the People's Courts to Prevent Conflicts of Interest" <http://en.pkulaw.cn/display.aspx?id=9319&lib=law&SearchKeyword=&SearchCKeyword=%c0%fb%d2%e6%b3%e5%cd%bb> accessed 12 February 2017.

<sup>15</sup>"Administrative Measures for the Practice of Law by Lawyers (2016 Revision)" <http://en.pkulaw.cn/display.aspx?id=22920&lib=law&SearchKeyword=&SearchCKeyword=%c2%c9%ca%a6%d6%b4%d2%b5%b9%dc%c0%ed%b0%ec%b7%a8> accessed 12 February 2017.

Lawyers”<sup>16</sup> and “Measures for Punishing Outraging Lawyers and Law Firms for Their Illegal Acts (2010)”<sup>17</sup> have stipulated that lawyers should comply with the basic principles regarding conflict of interest. In other words, there are several law-making bodies including the National People’s Congress, Ministry of Justice P.R.C, Chinese Bar Association, the Supreme People’s Court, and various local Bar associations. Each of them may, and some of them indeed, promulgate relevant rules, laws, interpretations, administrative rules, and guidelines. Two issues emerged as the result of this muddled law-making regime:

Firstly, the rules were promulgated by different bodies may have discrepancies with each other, which leaves lawyers’ subject to all of them in dilemma. For example, “Notice of the All China Lawyers’ Association on Issuing the Code of Conduct for Practicing Lawyers (2009 version)”<sup>18</sup> has more specified rules regulating conflict of interest compared with Lawyers’ Law of China or interpretations of the Supreme Court. The rules of Lawyers’ Association have its own downside, i.e., it has limitation in its scope of jurisdiction. In other words, association rules are internal guidelines applying only to lawyers and its force ceases to operate beyond the territory of Lawyer Association. Indeed the association rule, as a subordinate law residing in a lower position in the legal hierarchy, has less legislative effect, careful analysis still indicates that lawyers could be more easily held responsible for its alleged malpractice under the superordinate yet more broad association rule. The fact that the association rule is further detailed through, say, the self-regulation document lawyer’s internal guideline, only reduce but not eliminate this problem due to its lack of significant legislative effect. In other words, these different levels of regulation may result in lawyers creating misunderstandings and making errors in their work. Although the association rules clarify issues pertaining to conflict of interest and address the finer details, as lawyers’ internal guidelines, it is an autonomous document without much power. This would lead to the consequence that, if China wants to build a society with rule-of-law, the fundamental legal system must involve capability of predication, and then it will turn the trend toward heading to a rule-of-law society. And in this time, how law is practiced and how much is affected by law plays a significant role in this society.

Secondly, there are differences on the definition, recognition, and measures to be taken as to conflict of interest among different guidance issued by different local lawyer association. Following are specific examples: a big discrepancy remains

<sup>16</sup>“Code of Conducts for Lawyers (for Trial Implementation)” (《律师执业行为规范》) <http://en.pkulaw.cn/display.aspx?id=3530&lib=law&SearchKeyword=&SearchCKeyword=%c2%9%ca%a6%d6%b4%d2%b5%d0%ce%aa%b9%e6%b7%b6> accessed 12 February 2017.

<sup>17</sup>“Measures for Punishing Outraging Lawyers and Law Firms for Their Illegal Acts (2010)” (《律师和律师事务所违法行为处罚办法》) <http://en.pkulaw.cn/display.aspx?id=8022&lib=law&SearchKeyword=&SearchCKeyword=%c2%9%ca%a6%ba%cd%2%9%ca%a6%ca%2%ce%f1%cb%f9%ce%a5%b7%a8%d0%ce%aa%b4%a6%b7%a3%b0%ec%b7%a8> accessed 12 February 2017.

<sup>18</sup>“全国律协关于印发《律师执业行为规范》的通知(2009年)- 律师服务平台” [Notice of the All China Lawyers’ Association on Issuing the Code of Conduct for Practicing Lawyers (2009 Revision)] <http://fw.acla.org.cn:8088/serviceyewuzhunze/9393.jhtml> accessed 13 February 2017.

between “Beijing Rules of Avoiding Lawyer’s conflict of interest”<sup>19</sup> (hereinafter referred as “Beijing rules”) and “shanghai Bar Association Determination and Measures rules on conflict of interest”<sup>20</sup> (hereinafter referred as “shanghai rules”). Both rules agree that there has to be a gap starting from the date last client–attorney ended to the date the same lawyer starts to represent another client who has conflict of interest, but they differ on the exact time this gap should be. The Beijing rules satisfy on one year<sup>21</sup> while the Shanghai rules stipulate half a year.<sup>22</sup> Another example is about the definitions of conflict of interest. The Shanghai rules employ the method of classification to depict conflicts of interest under which conflicts of interest is further divided into direct conflicts and indirect conflicts. This method is similar to Hong Kong Law in their draft definition of conflict of interest. In contract, Beijing rules employ the method of enumeration under which all possible circumstances of conflict of interest being violated are listed clearly. The last example concerns disclaim by the client when conflict of interest arises. Shanghai rules give more interpretation about disclaim of conflict of interest for both direct conflicts and indirect conflicts separately, and relevant clauses are divided into several parts with different violation levels. There are also exceptions for violating disclaim clauses, but Beijing rules are more general. Lawyers holding national legal qualification should represent cases without territorial limitations. Diversity among rules in different regions may result in extra potential legal risks and compliance costs when rules to which lawyers practicing laws have to adhere are more complicated a complex.

## 9.2.2 Multiple Supervision and Penalty Systems

The diversity of rules governing conflict of interest, not surprisingly, leads to the problem of multiple supervision levels with different penalties existing in parallel. Before the “Notice of the All China Lawyers’ Association on Issuing the Code of

<sup>19</sup>“《北京市律师业避免利益冲突的规则》(试行)【经第五届理事会第八次会议通过,并于2001年6月27日起施行】”(Beijing Rules of Avoiding Lawyer’s Conflict of Interest) <http://www.beijinglawyers.org.cn/cgi/RnewsActiondetail.do?rid=1436497764942> accessed 14 February 2017. “Beijing Rules of Avoiding Lawyer’s Conflict of Interest”.

<sup>20</sup>“上海市律师协会律师执业利益冲突认定和处理规则 - 维权与纪律 - 律协规章 - 协会介绍 - 东方律师网”(Shanghai Bar Association Determination and Measures rules on conflict of interest) <http://www.lawyers.org.cn/info/12f43ae5268fb02fe0ecd36bb7033251> accessed 14 February 2017. “Shanghai Bar Association Determination and Measures rules on conflict of interest”.

<sup>21</sup>《北京市律师业避免利益冲突的规则》(试行)<<http://www.beijinglawyers.org.cn/cgi/RnewsActiondetail.do?rid=1436497764942>>【经第五届理事会第八次会议通过,并于2001年6月27日起施行】” 第九条第3款. (n. 19). (Beijing Rules of Avoiding Lawyer’s Conflict of Interest) Article 9 the Clause 3.

<sup>22</sup>“上海市律师协会律师执业利益冲突认定和处理规则 - 维权与纪律 - 律协规章 - 协会介绍 - 东方律师网”(n. 20) 第五条第8款. (Shanghai Bar Association Determination and Measures rules on conflict of interest) Article 5 the Clause 8.

Conduct for Practicing Lawyers (2011 Revision)”<sup>23</sup> is promulgated, there are penalty clauses in both the “Code of Conduct for Lawyers (for Trial Implementation)”<sup>24</sup> and “Lawyers’ Law of the People’s Republic of China”<sup>25</sup> (hereinafter referred as “Lawyers’ Law”). The two penalty clauses, however, are not only similar but also obviously overlap. Lawyers’ ethics and conduct are supervised by many entities, and the administrative penalties that may be imposed are in conflict too. Both a judicial administration office and a lawyer’s profession association are supervisors. For instance, Article 47 in Lawyers’ Law stipulates that: “For any of the following conduct of a lawyer, the justice administrative authority of the people’s government of a city with districts or the people’s government of a district of a municipality directly under the Central Government shall give a warning and may impose a fine of no more than 5000 Yuan; if there is any illegal income, shall confiscate the illegal income; and if the circumstances are serious, shall impose a penalty of cessation of practice for no more than three months...”<sup>26</sup> Article 50 also listed conducts of violating Lawyers’ Law.<sup>27</sup> However, based on China Lawyers’ Association document Article 105 in “Notice of the All China Lawyers’ Association on Issuing the Code of Conduct for Practicing Lawyers”<sup>28</sup>, the relevant penalty should be adopted from another official document which is called “Rules of violation of laws for lawyers association membership”<sup>29</sup>. The punishment includes imposing an admonition or a warning, circulating a notice of criticism, financial penalties, or rescindment of the lawyer’s association membership qualification. Additionally, a lawyer who grossly violates rules will be liable for his or her conduct after reporting to the judicial administrative department. Meanwhile, regarding violation of conflict of interest, the lawyer’s law firm would also be liable and the firm would be suspended or have its business license withdrawn. By analyzing the different penalty offices above, we can see that both the Lawyers’ Association and the judicial administrative department can make the penalty decision and the contents may overlap.

<sup>23</sup>“Notice of the All China Lawyers’ Association on Issuing the Code of Conduct for Practicing Lawyers (2011 Revision)” (n. 1).

<sup>24</sup>“Code of Conducts for Lawyers (for Trial Implementation)” (n. 16).

<sup>25</sup>“Lawyers’ Law of the People’s Republic of China (2012 Amendment)” (中华人民共和国律师法 (2012修正)) <http://en.pkulaw.cn/display.aspx?id=12576&lib=law&SearchKeyword=&SearchCKeyword=%c2%c9%ca%a6%b7%a8> accessed 17 February 2017.

<sup>26</sup>Ibid. Article 47.

<sup>27</sup>Ibid. Article 50 “For any of the following conduct of a law firm, the justice administrative authority of the people’s government of a city with districts or the people’s government of a district of a municipality directly under the Central Government shall give a warning or impose a penalty of cessation of practice for correction for not less than one month but not more than six months and may impose a fine of not more than 100,000 Yuan according to the circumstances; and if there is any illegal income, shall confiscate the illegal income; and if the circumstances are especially serious, the justice administrative authority of a province, autonomous region or municipality directly under the Central Government shall revoke the law firm’s practicing certificate:...”

<sup>28</sup>“Notice of the All China Lawyers’ Association on Issuing the Code of Conduct for Practicing Lawyers (2011 Revision)” (n. 1) Article 105.

<sup>29</sup>“律师协会会员违规行为处分规则(试行) - 中国律师网” “Rules of violation of laws for lawyer association membership” <http://www.acla.org.cn/hywxgz/11234.jhtml> accessed 17 February 2017.

### 9.3 Educative Meaning: Research on Conflict of Interest Is not Thorough Enough

At the time of writing, research in books and articles on conflict of interest in China is neither professional nor remarkable enough. Following problems are present. Firstly, the fact that there are few books on the subject and they could be literally counted by finger. Limited books include book titled “Rules of Lawyers’ professional conduct in America: theory and practice”<sup>30</sup> and translations named “Understanding Lawyers’ Ethics”<sup>31</sup> by scholar Jin-Xi Wang. Secondly, there are few published articles on this subject. There are no more than ten articles written on the topic of conflict of interest, like scholar Jin-Xi Wang’s article named “The Ethics of China’s Legal Profession-Reviewing the Past and Looking Forward to the Future”<sup>32</sup>, excluding master degree dissertation. Most relevant arguments spread around lawyers’ ethics books. Furthermore, the number of articles on conflict of interest has been decreasing in recent years, especially in the last five years. There are few articles published before 2012. Thirdly, the arguments are not remarkable. Most of them are focusing on introducing a basic definition of conflict of interest and opinions with depth are rare. Scholar Shifa Long has pointed out some new opinions on the subject.<sup>33</sup> Students are also lacking interest in this topic because most degree papers were written before 2011. Considering the speed of development in China, especially in the majority of modern cities, the progress of academic research is far behind because the legal business is growing fast in China. Thus, it is necessary to uncover theoretical research on conflict of interest and to standardize the relevant rules of lawyers’ conduct. This could help Chinese lawyers reduce the potential risks and costs when they practice law.

<sup>30</sup>王进喜, 美国律师职业行为规则理论与实践 (中国人民公安大学出版社 2005), Jin-xi Wang, “Rules of Lawyer’s professional conduct in America: theory and practice,” People’s Public Security University of China publish, 2005. [http://xueshu.baidu.com/s?wd=paperuri:3A%2840533c05bdef8b14c2c586b1a7c29557%29&filter=sc\\_long\\_sign&sc\\_ks\\_para=q%3D%E7%BE%8E%E5%9B%BD%E5%BE%8B%E5%B8%88%E8%81%8C%E4%B8%9A%E8%A1%8C%E4%B8%BA%E8%A7%84%E5%88%99%E7%90%86%E8%AE%BA%E4%B8%BF&tn=SE\\_baiduxueshu\\_c1gjeupa&ie=utf-8](http://xueshu.baidu.com/s?wd=paperuri:3A%2840533c05bdef8b14c2c586b1a7c29557%29&filter=sc_long_sign&sc_ks_para=q%3D%E7%BE%8E%E5%9B%BD%E5%BE%8B%E5%B8%88%E8%81%8C%E4%B8%9A%E8%A1%8C%E4%B8%BA%E8%A7%84%E5%88%99%E7%90%86%E8%AE%BA%E4%B8%BF&tn=SE_baiduxueshu_c1gjeupa&ie=utf-8) accessed 18 February 2017.

<sup>31</sup>弗里德曼, 史密斯, 卫东王, 律师职业道德的底线 北京大学出版社 2009. “*Understanding Lawyers’ Ethics*” Freedman, Monroe H. Smith, Abbe. Wei-dong Wang. Beijing University Publishing, 2009. [http://xueshu.baidu.com/s?wd=paperuri:\(da9070a0f640a4a2fff1aed449301bad\)&filter=sc\\_long\\_sign&sc\\_ks\\_para=q%3D%E5%BE%8B%E5%B8%88%E8%81%8C%E4%B8%9A%E9%81%93%E5%BE%B7%E7%9A%84%E5%BA%95%E7%BA%BF&tn=SE\\_baiduxueshu\\_c1gjeupa&ie=utf-8&sc\\_us=6093275800266107923](http://xueshu.baidu.com/s?wd=paperuri:(da9070a0f640a4a2fff1aed449301bad)&filter=sc_long_sign&sc_ks_para=q%3D%E5%BE%8B%E5%B8%88%E8%81%8C%E4%B8%9A%E9%81%93%E5%BE%B7%E7%9A%84%E5%BA%95%E7%BA%BF&tn=SE_baiduxueshu_c1gjeupa&ie=utf-8&sc_us=6093275800266107923) accessed 18 February 2017.

<sup>32</sup>王进喜, “中国律师职业道德:历史回顾与展望” [2005]-2 中国司法 40. Jin-Xi Wang, “The Ethics of China’s Legal Profession-Reviewing the Past and Looking Forward to the Future,” *Judicature Today*, 2005(02).

<sup>33</sup>龙世发, “律师执业利益冲突规则研究——基于中美法学教材的比较” [2011] 法治与社会(Legal System And Society) 283页. Long-Shifa, “A Lawyer’s practice research-Conflict of Interest Rules based on the Comparison of America Textbook and Chinese one,” *Legal System And Society*, 2011(09).



## 9.4 Analysis of Conflict of Interest Compared to Common Law

K Zweigert has noted that comparative law as a school of truth can expand and enrich the store of resolutions.<sup>34</sup> It is helpful to analyze conflict of interest by comparing western countries' legal systems. Therefore, this part will introduce and analyze the principles including withdrawal and immunity.

### 9.4.1 England's Law in the UK

#### Principles on conflict of interest

England's Solicitors Regulation Authority issued a document titled "solicitors' Practice Rules 1990" (hereinafter referred as "the SPR"), and its Article 16D defined conflict of interest as interests of two or more clients in relation to the same or related matters as your own or interests of any client in relation to a matter conflicting with your own.<sup>35</sup> It also promulgated standards of determining if there is a conflict of interest. If there is a conflict of interest and the rules that the lawyers shall not to continue to act for one of the clients.<sup>36</sup>

#### Principles of withdrawal and immunity

##### (a) Withdrawal system

England's Solicitors Regulation Authority stipulated a withdrawal rules regarding conflict of interest which covers two aspects. One is about accepting gifts from

<sup>34</sup>K. 茨威格特, H. 克茨, 潘汉典, 米健. 比较法总论 (法律出版社 2003) 22页. Konrad Zweigert, Hein Kötz, translated by Han-dian Pan, Jian Mi and others "An Introduction to Comparative Law," Law Press China, 2003, page 22. [http://xueshu.baidu.com/s?wd=paperuri%3A%28a5996d73b3fb464961f857bfc166904c%29&filter=sc\\_long\\_sign&sc\\_ks\\_para=q%3DAn%20Introduction%20to%20Comparative%20Law&sc\\_us=14429273634918316377&tn=SE\\_baiduxueshu\\_c1gjeupa&ie=utf-8](http://xueshu.baidu.com/s?wd=paperuri%3A%28a5996d73b3fb464961f857bfc166904c%29&filter=sc_long_sign&sc_ks_para=q%3DAn%20Introduction%20to%20Comparative%20Law&sc_us=14429273634918316377&tn=SE_baiduxueshu_c1gjeupa&ie=utf-8) accessed 18 February 2017.

<sup>35</sup>'solicitors Practice Rules 1990.pdf' page 33:

SPR-16D(2)(b), there is a conflict if:

(i) you owe, or your practice owes, separate duties to act in the best interests of two or more clients in relation to the same or related matters, and those duties conflict, or there is a significant risk that those duties may conflict; or

(ii) your duty to act in the best interests of any client in relation to a matter conflicts, or there is a significant risk that it may conflict, with your own interests in relation to that or a related matter.

(iii) For paragraph (2)(b) above, a related matter will always include any other matter which involves the same asset or liability. <https://www.whatdotheyknow.com/request/63467/response/157855/attach/3/Solicitors%20Practice%20Rules%201990.pdf> accessed 18 February 2017.

<sup>36</sup>Ibid 34. Article 16D(4): if you act, or your practice acts for more than one client in a matter and, during the course of the conduct of that matter, a conflict arises between the interests of two or more of those clients, you, or your practice, may only continue to act for one of the clients (or a group of clients between whom there is no conflict) provided that the duty of confidentiality to the other clients is not put at risk.

clients. When clients are asked to give gifts to either lawyers themselves, or any proprietor, or a member of their family, it can be regarded as accepting gifts from clients. If the gift is of a significant amount, or having regard to the size of the client's estate and the reasonable expectations of the prospective beneficiaries, the lawyer must advise the client to take independent advice about the gift unless the client is a member of the beneficiary's family. If the client refuses, the lawyer must stop acting for the client in relation to the gift.<sup>37</sup> On the other hand, if a lawyer's proprietor or employee in their practice, or a member of their family holds some public office or appointment, the lawyer may not be able to provide reasonable advice while acting on behalf of their client, in which case they should withdraw their service from this client.<sup>38</sup>

#### (b) **Immunity system**

A lawyer or lawyer's practice may act for two or more clients in relation to a matter in situations of conflict or possible conflict if all the clients have given in writing their informed consent to the lawyer or their practice's acting. This is the exception to duty not to act, referred to as the immunity system.

### 9.4.2 *California Law in the USA*

There is a big difference between US law and UK law regarding conflict of interest. "California Rules of Professional Conduct" (hereinafter referred as "the CRPC") states that the conflict of interest between lawyers and clients can be treated as "Adverse Interest."<sup>39</sup> In principle, lawyers should avoid the representation of adverse interests which means "avoiding the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client."<sup>40</sup> The core of conflict of interest is conflict between the lawyer's representing or acting and the client's interest. Because the lawyer should guarantee their clients that they are devoted to their interests, it would follow that the lawyer has difficulty in protecting and promoting clients' interests while acting on their behalf if there is a conflict of interest.<sup>41</sup> The CRPC clearly avoids that: "a member shall not enter into a business transaction with a client; or knowingly acquire

<sup>37</sup>Ibid 35. Article 16D(5).

<sup>38</sup>"solicitors Practice Rules 1990.pdf" (n. 35). Article 16D(6).

<sup>39</sup>"California Rules of Professional Conduct" <https://www.law.cornell.edu/ethics/ca/code/> accessed 19 February 2017.

<sup>40</sup>Ibid Rule 3-310.

<sup>41</sup>蔡云玺, "律师伦理规范法制研究:以我国、美国(加州)与英国(英格兰)法制为比较"(硕士论文,台湾大学社会科学院国家发展研究所 [2005]-01. 21页. Yun-Xi Cai, "Research on Lawyers' Ethics in legal system—comparing with China, America (California) and UK (England)," Master Degree Dissertation, National Taiwan University Social Science College Research Center, 2005(01), page 21.

an ownership, possessory, security, or other pecuniary interest adverse to a client.”<sup>42</sup> Besides, the law allows that a lawyer can do business with clients only if certain requirements have been satisfied.

US law does not allow lawyers to have invisible business with clients and gain non-performance interest before lawyers take proper measures. Because there is a service contract relationship between lawyer and client, the client must provide their trust and depend on the lawyer's action, and it requires the lawyer to be loyal to their client in all circumstances. A lawyer's property business action with a client is severely restricted so that if a lawyer uses their unequal position or their client's trust to interfere with the client's decision, the lawyer's action is illegal.

The treatment of conflict of interest in US law is elaborate. Although some British academic circles dissent from America's position on conflict of interest,<sup>43</sup> both UK law and US law generally put the client's legal interest as the most important. In other words, the lawyer must service their client completely and satisfactorily. The client has the right to know if there is a conflict of interest. After the client discovers the existence of adverse interests, the client may give informed written consent to permit their lawyer's action excepting legal withdrawal terms,<sup>44</sup> while the lawyer should follow their client's requirements and persist in treating the client's interest as highest priority during the whole legal service period.

## 9.5 The Basic Principles and Measures of Improvement of Chinese Conflict of Interest

Lawyers' professional conflict of interest is a significant part of the Chinese legal system. Although there are many overseas advanced theories and tried rules that can work as reference points for China to learn from, it is still difficult for China to change or improve this part of its law, because reworking Chinese lawyers' professional rules regarding conflict of interest requires not only overseas resolution but also a path to the resolution of the national situation. Respecting clear law is still a fundamental element of each legal system.<sup>45</sup> When conflict of interest rules need to be adjusted or improved, the work should cover the whole legal framework instead of issuing amendments separately. This process would involve many challenges, and it might be the most significant reason why both academic and practice circles have been unable to make a tangible breakthrough in this area. To get to the root of this problem, this paper argues that the current situation in regard to Chinese lawyers' professional

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<sup>42</sup>“California Rules of Professional Conduct” (n. 39) Rule 3–300.

<sup>43</sup>John S Dzienkowski, “Positional Conflicts of Interest” (1993) 71 Texas Law Review 457.

<sup>44</sup>“California Rules of Professional Conduct” (n. 39). The withdrawal terms were concerned with reasons of lawyers being less able to provide effective and impartial legal service for their clients.

<sup>45</sup>K.茨威格特, H.克茨, 潘汉典, 米健. 比较法总论 (法律出版社 2003) 22页. Konrad Zweigert, Hein Kötz, translated by Han-dian Pan, Jian Mi, and others “An Introduction to Comparative Law,” Law Press China, 2003, page 22.

conflict of interest is in a confusing state, and that the main reason is that there is no clear and accurate definition of the lawyer's role in practice.

### Clarifying the role of lawyer

The legal profession is also a social profession. The emergence of legal profession and the improvement of lawyer's profession are both influenced by contemporary development of society and economy. In traditional authoritarian society, lawyers used to wear "judicial police uniforms" to practice law. Later on, the role of lawyer became that of a "national law worker" and eventually it changed to a "social legal job." So far, some scholars agree with the definition of lawyer as "a person who independently provides legal services to society" or a "non-governmental judicial member"<sup>46</sup> and many social duties are conferred on the law profession.

The first step of clarifying the role of lawyer is to figure out lawmaker's intention through reading the whole relevant stipulates, so that we can understand how the legislation department stipulates rules on defining the lawyer's role. The Lawyers' Law in Article 2 puts the definition of lawyer as follows: "A lawyer as mentioned in this Law shall refer to a practitioner who has acquired a lawyer's practicing certificate according to law and accepts authorization or appointment to provide legal services for a client".<sup>47</sup> In summary, the role of lawyer can be described as servicing professional legal knowledge for clients. As far as considering the characteristics of it, there is no great difference to other service professions because lawyers use their knowledge and experience of the law to satisfy their clients' requirements. "A lawyer shall maintain the legal rights and interests of a client, maintain the correct enforcement of law, and maintain the social fairness and justice."<sup>48</sup> This clause entrusts more duties and responsibilities to lawyers, because lawyers should not only provide service to clients and protect clients' interests but they also need to practice law impartially and to safeguard justice in society. Furthermore, we could break down this definition of enhanced lawyer's duty by using three different angles. Firstly, a lawyer protecting a client's legal rights is based on the party's or the client's interests. Secondly, a lawyer must support the proper and impartial application of the law and this requires standardized rules. Thirdly, safeguarding justice is enhanced as far as building an orderly society is concerned. If we analyze lawyer's duty from different angles, then the expectations of a lawyer's behavior toward clients, society, and nation can be different due to the lawyer's different duties. Thus, if there is a conflict of interest between these three duties affecting the lawyer's practice, how should the lawyer respond or choose which interest takes priority? It is unlikely that a client would allow the lawyer to treat society's interest or national interest as more

<sup>46</sup>郑建伟, "我国律师角色定位探讨" 2012(02) 法制与经济(中旬); Jian-wei Zheng, "Discussion on role definition of lawyer in China", 2012(02), Legal and Economy (mid-). 江帆, "和谐社会中的律师角色定位" 2007(12) 中国律师 Fan Jiang, "Role Definition of lawyer in Harmonious China," 2007(12) Chinese Lawyer. 蔡丽 和 石羨, "中国律师的角色定位" 2007(05) 中共福建省委党校学报, Li Cai and Xian Shi, "Role Definition of Chinese Lawyer," 2007(05), Journal of Fujian Provincial Committee Party School of CPC.

<sup>47</sup>"Lawyers' Law of the People's Republic of China (2012 Amendment)" (n. 25) Article 2.

<sup>48</sup>Ibid.

important than his own and the client could not support the lawyer abandoning their interest to decide on the trend of progress in their case. This is also in opposition to the lawyer's professional ethics. "The most important function of lawyers is to protect clients' legal rights."<sup>49</sup> The client trusts the lawyer to represent their interest positively and reliably. After building this fiduciary relationship between the client and the lawyer, the lawyer must represent their client consistently and loyally. It is this all important trust which makes a lawyer represents their client's interests over and above their own.<sup>50</sup> Besides, as representatives of clients and public citizens, they have particular responsibilities for the quality of justice. When a lawyer acts incorrectly and impatiently in regard to the facts of a case and their legal knowledge, this may not satisfy the expectation of public citizens. This may then lead to criticism of the legal profession especially on the Internet.

In summary, this paper supports that the obligation of representing clients is a positive duty and representing officers of the legal system and public citizens is a negative duty for lawyers, because the negative duties have educating and warning roles rather than practicing law; therefore, the law profession is the profession which provides legal services and represents its clients independently.

### **Improvement of conflict of interest law**

Defining the lawyer's role as a fundamental and necessary factor for developing a legal system is beneficial for properly building more standards. On the one hand, the lawyer must put the client's interest first when they provide legal service for the client, and if there is a conflict of interest, the lawyer should consider the client's legal rights first; on the other hand, the law profession is independent in society but the lawyer is obligated and liable by professional authority, supervision, and rules.

### **Amending the framework of conflict of interest rules**

Taking all the factors above into consideration, we see that local judicial offices issue different documents such as "Code of Conduct for Practicing Lawyers" or "Lawyer Professional Discipline Rules." This is localization with local powers of authority, and it is most ineffective for lawyers due to the subordinate hierarchy. Although "Lawyers' Law" is a specific law regulating lawyers' conduct, the conflict of interest topic is still a landscape waiting to be sculpted. This paper aims to give some fresh creative views, and these might be predictable thoughts on making laws regarding conflict of interest.

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<sup>49</sup>李卫东, "社会变迁与中国近代律师制度的产生" (2006) 2 中国律师和法学家 Wei-dong Li, "society Change and Lawyer rules in Modern China," 2006(2), Journal of China Lawyer and Jurist </document/1d87704250d477c9318947a18e7f9386.html> accessed 22 February 2017.

<sup>50</sup>Sciavicco, Lindsey Beth. "If You Can't Trust Your Lawyer, Who Can You Trust?: Why Conflicts Of Interest And Client Loyalty Require An Exception To The Intra-Firm Attorney-Client Privilege For Current Clients." Georgia Law Review 48.4 (2014): 1225-1262. Academic Search Premier. Web. 21 Feb. 2017.

## Enumerating typical circumstances of conflict of interest<sup>51</sup>

As discussed above, conflict of interest is an undefined boundary in China and legal workers must define it using only their own legal experiences in practice<sup>52</sup>, and there are no standard rules to follow.<sup>53</sup> If the typical circumstances surrounding conflict of interest could be clearly set out in law, using an enumeration system, it would become the standard for lawyers to refer to and follow. Meanwhile, it would also provide a standard of reference for supervisors to decide punishments. However, the world is undergoing rapid change and it is increasingly difficult for lawmakers to enumerate all the different aspects of conflict of interest. Even if the law covers all circumstances, which are viewed as typical today, they are like to change in future and may become just ordinary circumstances. Thus, taking legislative technique into consideration, this paper supports that there should be general laws defining circumstances of conflict of interest, because it would leave space for lawmakers to interpret or amend the law. Leaving a blank space is an artistic technique but it is also important for legislation.

## Withdrawal and immunity of conflict of interest

It is a mandatory rule in both, Western and Chinese law, that a lawyer cannot represent both parties in one case at the same time. In practice, an attorney–client’s interest might be adverse to other parties in a case. The aim of conflict of interest laws is to prevent damage to a client’s interest caused by their lawyer’s representation or their professional conduct in a case. Therefore, the withdrawal system is necessary if a client’s interest is adverse to relevant parties. This is a preventive measure to avoid unnecessary damage to any party’s interest in the case. Withdrawal measures are obligations of omission and are different to a lawyer’s other acting obligations.

Indeed, the attorney–client relationship between a lawyer and client is bound by their legal service contract and both client and lawyer’s rights and obligations are governed by this bilateral contract. When a client entrusts a matter to a lawyer or legal adviser, the purpose is to protect the client’s legal rights and interests, and the lawyer receives an agreed remuneration as exchange. The lawyer is liable to represent the client’s interest, but while it is expected that the lawyer uses his professional legal knowledge to fight for their client, it is important to pay close attention to any invisible damage that may result from the lawyer’s conduct. If a conflict of interest or

<sup>51</sup>蔡 (n. 40) page 130–131. Cases which can be defined as avoiding conflict of interest are merely limited by a few specific types in England. And the law permits lawyers to represent an attorney–client and interests adverse to the attorney–client’s interests at the same time as long as the attorney–client agrees with that. But in the USA, the law is stricter compared with California’s law, because a lawyer could represent any client after the attorney–client agrees with this, and it won’t touch any non-disclosure agreement in principle.

<sup>52</sup>This paper’s author has conducted several interviews with practicing lawyers. They all misunderstood the definition of conflict of interest as representing both parties simply and inaccurately.

<sup>53</sup>See in “律師倫理規範” (法源法律網) Taiwan “Lawyer’s Ethics Rules” (Law Bank) and this point is similar to Taiwan’s rules in Article 30, 32, and 38. <http://www.lawbank.com.tw/treatise/la wrela.aspx?lisd=FL010136&ldate=20090919&lno=30,30-1,30-2,32> accessed 22 February 2017.

a potential risk, which will damage the client or another party, comes to light during the lawyer's representation, then the lawyer must report these adverse circumstances to their client if a conflict of interest occurs. The lawyer must temporarily cease to represent the client, until said client gives their informed written consent. In other words, a lawyer can only continue their attorney–client relationship and represent the client when he or she is permitted by the client's informed written consent. Based on the notion of autonomy of private law,<sup>54</sup> although the consequence of this conduct might not be beneficial to the client, if the client gives their informed written consent, the lawyer enjoys immunity from prosecution.

## 9.6 Increasing Number of Independent Punishment Offices

Chinese Lawyers' Law Article 4 stipulates that there are supervision offices including the justice administrative authorities, law firms, and Lawyers' Association.<sup>55</sup> The problem is that the administrative authority's power to punish lawyers and law firms is against the legal profession. Because the Lawyers' Association's spirit is self-discipline and self-autonomy, and this affects the independence of lawyers' conduct directly, even lawyers' acting would be limited by it, as they practice law. Hence, China could learn from other countries' experiences especially in the UK and the USA. These countries have established independent judicial administrative offices aiming to supervise lawyers' conduct through punishment and to standardize specific relevant rules. It is worth mentioning that these offices would govern all, including exercising authority to punish lawyers and law firms or even law associations, under the unified leadership.<sup>56</sup>

### Systematics of conflict of interest

Chinese lawyers' professional conflict of interest needs to be expanded, not only by amending rules or adjusting principles but also by developing a mature system as a guarantee. Depending solely on written rules to attain a perfect legal system is not realistic. Implementing conflict of interest rules effectively demands that many factors be considered. For example, to enhance the lawyer's capability of practicing independently is important, to shape the lawyer's professional ethic and morality are necessary, and to promote the Lawyers' Association's practice of self-discipline and to be supervised by public officials are significant. Otherwise, lawyers' professional conflict of interest would become a mirage.

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<sup>54</sup>The notion of autonomy of private law pertains to a rational economy person, and it is believed that a rational economy person can make a choice which is compatible with their own best interest.

<sup>55</sup>"Lawyers' Law of the People's Republic of China (2012 Amendment)" (n. 25). Article 4: The justice administrative authorities shall supervise and provide guidance for lawyers, law firms, and lawyers' accordance in accordance with this law.

<sup>56</sup>李军, "两岸律师伦理规范比较研究成都理工大学学报", (社会科学版) 2014(06). Jun-Li, "A Comparison between the Legal Ethics across the Taiwan Stra," Journal of Chengdu University of Technology (Social Sciences), 2014(06).

## 9.7 Conclusion

Chinese Lawyers' Law is a law with a strong political slant similar to other laws, and its characteristic of defining the role of lawyer is prominent and is inaccurate unless it is strongly operational. This paper seeks to analyze the purpose of legislation and point out that the lawyer as a legal practice "executive" has the duty to protect the client's interest and legal rights. Considering that the role of lawyer is unique and that lawyers' have the ability and opportunity to promote understanding of clients' information, lawyers are obligated to be loyal to their clients. Furthermore, lawyers are also liable if they use attorney-client relationships and/or their unequal position to risk clients' information, interest, or legal rights. It means potentially taking unpredictable risks for clients but lawyers are governed by law and administrative offices so that they are liable if they seek interests for themselves or other parties, and this constitutes a conflict of interest. Only if the fiduciary relationship between client and lawyer can be maintained properly, and it can become the fundamental reason for people to trust each other will people be able live peacefully in a society of trust, even if there are unreliable matters in some relationships.<sup>57</sup> This paper predicts boldly that the trend of change in regard to conflict of interest in China is to build a trust relationship between lawyer and client based on a relationship of confidence, which is equal and mutually beneficial, on independent service and working under a supervised system. There should be more demonstrations of standard rules regulating conflict of interest after taking the whole picture of the legal system into consideration, and it would be beneficial to rectify the principles of conflict of interest. Meanwhile, the law profession may progress on the path of self-autonomy and self-discipline. There is no doubt that there will be more room for discussion on the subject of conflict of interest, for example, the relationship between conflict of interest and lawyers' professional independence, lawyers' professional ethics, and morality regarding conflict of interest rules. This paper does not cover all the topics due to space but the author would like to encourage questions and bring attention to both academic and practice scholars for reference.

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<sup>57</sup> 卡尔·拉伦茨,拉伦茨,王晓晔, 德国民法通论 (法律出版社 58页 2004). Karl Larenz, *Allgemeiner Teil des deutschen Bürgerlichen Rechts*, München 1960. Mehrfache Neuauflagen. page 58. [http://xueshu.baidu.com/s?wd=paperuri%3A%28d6fe5d72094f452dc0fb39a1d8bb764d%29&filter=sc\\_long\\_sign&sc\\_ks\\_para=q%3D%E5%BE%B7%E5%9B%BD%E6%B0%91%E6%B3%95%E9%80%9A%E8%AE%BA&sc\\_us=10098268932062861813&tn=SE\\_baiduxueshu\\_c1gjeupa&ie=utf-8](http://xueshu.baidu.com/s?wd=paperuri%3A%28d6fe5d72094f452dc0fb39a1d8bb764d%29&filter=sc_long_sign&sc_ks_para=q%3D%E5%BE%B7%E5%9B%BD%E6%B0%91%E6%B3%95%E9%80%9A%E8%AE%BA&sc_us=10098268932062861813&tn=SE_baiduxueshu_c1gjeupa&ie=utf-8) accessed 22 February 2017.



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**Part III**  
**Economic Justice and Professional Ethics**

# Chapter 10

## Privacy Policy and Security Issues in E-Commerce for Eliminating the Ethical Concerns



Ayşegül Donmaz

### 10.1 Introduction

Recent advances in technology have created a surge in “technology-based self-service.” Such developments are changing the way that service firms and consumers interact and are raising a host of research and practice issues relating to the delivery of e-service. E-service is becoming increasingly important not only in determining the success or failure of electronic commerce, but also in providing consumers with a superior experience with respect to the interactive flow of information (Rowley 2006). However, the rapid advance of information technology in e-commerce also raises complex ethical questions about consumer rights and end user Internet privacy (Hettche 2009). Dynamic technological frontiers, including the Internet and mobile devices that facilitate instant communication and connectivity, bring new challenges, not the least of which involves the ethics of conduct using such technology. Concerns about what constitutes appropriate online conduct have been around for some time (Williamson et al. 2011).

One of the ways that Web-based businesses make money is by collecting information about visitors to their Web sites and then capitalizing on the use of that information. This raises grave question about privacy rights of Internet customers. Internet privacy is currently a hot-button topic and has received a lot of newsprint attention (Maury and Kleiner 2002). Consumers’ privacy concerns have become more heightened as information technologies have enabled online retailers to collect increasing amounts of consumer information. Through direct observation, retailers can record a consumer’s on-site browsing behavior, purchase history, and shipping and billing information. Moreover, retailers can add to this information over time, aggregate it across multiple databases, or easily transfer it to third parties (Tang et al. 2008). Therefore, privacy concerns for B2C e-commerce became an important issue because of the direct involvement of customers and the organization’s potential ability to access, store, and share this personal information (Liu et al. 2005).

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Privacy has been defined as the right of an individual to be left alone and able to control the release of his or her personal information (Liu et al. 2005). Thus, the construct of privacy refers to companies not sharing information with third parties unless the customer gives permission. It also includes the security of sensitive information between the customer and the company. In addition, this includes providing visual symbols so customers know a secure connection is being achieved (Collier and Bienstock 2006).

Stead and Gilbert (2001) define privacy as “the condition of not having undocumented personal knowledge about one possessed by others” and present an ethical framework through which privacy concerns should be viewed. With regard to Web interactions and e-commerce, the following dimensions are most salient:

- Privacy consists of not being interfered with, having the power to exclude; individual privacy is a moral right.
- Privacy is “a desirable condition ... with respect to possession of information by other persons about him/herself on the observation/perceiving of him/herself by other persons.”
- Facts pertaining to objects owned, and monies earned are held to be private by one’s ownership.

It is a great obligation and duty for prosperous electronic commerce Web sites to ensure visitors that their personal privacy and security are reserved when logging into a Web site. E-commerce Web site operators have to prevent any of customer information being available to unauthorized and not permitted users (Leitch and Warren 2001). Many experts believe the lack of trust between transacting parties, and the system facilitating the exchange is impeding the speed at which this potential has yet to be realized (Dinev et al. 2006). Since perceived mistrust by customers acts as a serious threat to the growing of any enterprise, it is imperative for enterprises to identify and manage these business risks in order to expand, speed up, and maintain customers’ trust in e-commerce activities (Maleki and Akbarzadeh Pahsa 2012). Trust is the willingness of one party to be subject to the risks brought by another party’s actions. In the context of online privacy protection, these risks arise from uncertainty or incomplete information about retailers’ actions regarding customer information. For example, security breaches may occur due to inadequate data protection or internal controls; retailers may engage in unauthorized secondary uses, such as using information that is collected for one purpose for a different purpose (Tang et al. 2008). Pavlou et al. (2007) pointed out that uncertainty will lead to two information problems-hidden information and hidden action.

Privacy refers to an individual’s ability to control when, how, and to what extent his or her personal information is communicated to others. The notion of privacy has recently come to be viewed as a critical ethical issue that deserves attention from both scholars and practitioners (Son and Kim 2008). In order to protect privacy, it is therefore necessary to address the responsibilities of both the organizations that collect personal information and the organizations that receive it secondarily. In order to ease customers’ concerns, organizations worldwide have begun to issue privacy policies or statements on their Web sites. These are descriptions of sites’ practices

for the online collection, use, and dissemination of personal information (Liu et al. 2005).

To ensure privacy, there have been a number of initiatives in the field of privacy protection on the Internet, with the most popular being the growth in the display of privacy policies on Web sites. A privacy policy is a description written by or on behalf of an organization detailing their practices regarding the collection and use of information (Mundy 2006). Organizations have both internal policies, which include rules about information handling within an organization, and external policies which are designed to inform the data subjects about use of their information. A privacy policy is essentially a comprehensive and high-level description of organization's privacy practices (Karat et al. 2005).

In 1999, the Federal Trade Commission developed five fair information practices for Criteria for a Good Privacy Policy (Bowie and Jamal 2006):

- Notice/awareness: covers the disclosure of information practices, including a comprehensive statement of information use;
- Choice/consent: includes both opt-out and opt-in options and allows the consumers the choice to trade information for benefits, depending on the value consumers place on the benefits;
- Access/participation: allows for confirmation of the accuracy of information; necessary when information is aggregated from multiple sources;
- Integrity/security: controls for theft or tampering; and
- Enforcement/redress: provides a mechanism to ensure compliance; this mechanism is an important credibility cue for online companies, but is extremely difficult to accomplish effectively.

The most obvious moral requirement is that an e-commerce Web site should have a privacy policy. In the absence of a policy, the notice/awareness criterion cannot be met. Second, the policy should be easy to find and easy to read, i.e., not legalistic. To be easy to find, the privacy policy should be clearly stated on the homepage or at the site where personally identifiable information (PII) is collected. Normally, the statement of the privacy policy should be one click away to meet the "easy to find" requirement (Bowie and Jamal 2006).

One of the main problems with privacy policies is their lack of uniformity. This plethora of poorly written privacy policies results in a clear mismatch between what organizations think their users wish to know and what their users actually wish to know. Lack of standards also makes it difficult to compare privacy policies against user requirements (Mundy 2006). According to Guarda and Zannone (2009), privacy policies shall contain information regarding (Maleki and Akbarzadeh Pahsa 2012):

- The purposes and modalities of the processing for which the data are collected;
- The obligatory or voluntary nature of providing the requested data;
- The categories and typologies of data concerned;
- The recipients or categories of recipients;
- The rights of data subjects.



As Anday et al. (2012) put it: “there exists a genuine gap between the privacy protection that the users believe they can expect from a Web site and the preparedness of e-commerce Web site operators for providing this protection.” The ethical dimension of privacy is described in Neuhaus’ study (2003) as three broad ways for unethical ways of data collection. First of all, the data itself might be private or confidential, “so the mere collection of the data represents an invasion of privacy.” Also, “the methods to collect the data might be unethical” and thirdly, “the use of data may be unethical” (Anday et al. 2012). Internet Architecture Board (IAB) has defined an activity as unethical and unacceptable if it (Maleki and Akbarzadeh Pahsa 2012):

- Seeks to gain unauthorized access to the resources of the Internet,
- Disrupts the intended use of the Internet,
- Wastes resources (people, capacity, and computer) through such actions,
- Destroys the integrity of computer-based information, or
- Compromises the privacy of users.

As the entire business of e-commerce evolves, so does its sensitivity to ethical considerations. It is increasingly apparent to those who do business on the Web that there is an overwhelming need to instill ethical values into this industry. By doing so, Web sites will not only promote consumer and investor confidence but ultimately will also benefit (Maury and Kleiner 2002).

Radin et al. (2007) listed ethical issues in e-commerce including privacy, security concerns, Web sites unlabeled as advertising, cybersquatters, online marketing children, conflicts of interest, and manufacturers competing with intermediaries online. According to some studies of ethical issues facing the Internet, the most often mentioned ethical concerns regarding marketing on the Internet are security of transactions, illegal activity (e.g., fraud and hacking), privacy, honesty/trustfulness, judgment by same standard as other media, pornography, product warranty, plagiarism, targeting children, unsolicited e-mails, and false advertising (Yang et al. 2009).

## 10.2 The Literature Review on Privacy and Security Issues and Ethical Concerns

The literature review about the privacy and security issues of e-commerce and ethical concerns is highlighted here, and a summary of the characteristics for 24 studies are presented in the following table. The key words “privacy,” “security,” “ethics,” and “e-commerce” were used while searching for the topic and relied on the Ebscohost, Emerald, Taylor & Francis, and Wiley Online Library databases for this literature search that exist from 2001 to 2014.

SQ	Article	Authors	Year Country	Sample	Keywords	Journal
1	Ethical Challenges: Customers' Rights	Morteza Maleki and Maryam Akbarzadeh Pasha	2012 Iran	Conceptual Study	E-commerce, Ethical Challenges, Trust, Privacy, Security, Advertising, Children Protection	SCMS Journal of Indian Management
2	Business Under Threat, Technology Under Attack, Ethics Under Fire: The Experience of Google in China	Justin Tan and Anna E. Tan	2012 Canada	Conceptual Study	Google, China, Corporate Social Responsibility, Business Ethics, Internet Search Engine, Privacy, Copyright	Journal of Business Ethics
3	Information Security Issues in a Digital Library Environment: A Literature Review	Audrey Anday, Enrico Francese, Hugo C. Huurdeman, Muharrem Yilmaz and Dydimus Zengenene	2012 Turkey	Conceptual Study	Information security, Digital libraries, Data protection	Bilgi Dünyası
4	A Social-Cognitive Approach to Marketing Ethics: Institutionalization, Integrity, and Power	Ceri M. Nishihara	2012	Empirical Study	Ethics, morality, ethical behavior, Social Cognitive Theory	The University of Mississippi
5	Online Privacy Concerns Associated with Cookies, Flash Cookies, and Web Beacons	Janice C. Sipior, Burke T. Ward, and Ruben A. Mendoza	2011 USA.	Conceptual Study	Beacons, cookies, Flash cookies, information privacy concerns, Internet, online information privacy, privacy, Web tracking	Journal of Internet Commerce
6	Ethical Issues in the Age of the Internet: A Study of Students' Perceptions Using the Multidimensional Ethics Scale	Stan Williamson, Kenneth E. Clow, Bruce C. Walker and T. Selwyn Ellis	2011 USA.	Empirical Study—440 responses were received from two universities, 110 for each scenario	Internet ethics, Internet privacy—accuracy—property—accessibility (PAPA), Multidimensional Ethics Scale (MES)	Journal of Internet Commerce
7	The Effect of Perceived Ethical Performance of Shopping Web sites on Consumer Trust	Ming-Hsien Yang, Natalyn Chandlrees, Binshan Lin and Hung-Yi Chao	2009 Taiwan	Empirical Study—238 valid responses from two large universities in Taiwan	Consumer perception, electronic commerce, online shopping, Web site, ethical performance, trust, trusting belief, perceived ethical performance, trusting intention	Journal of Computer Information Systems

SQ	Article	Authors	Year Country	Sample	Keywords	Journal
8	Privacy, E-Commerce, and Virtual Property: Outlining a Lockean Theory of Internet Consumer Rights	Matt Hetteche	2009 USA.	Conceptual Study	Digital information, e-commerce, intellectual property, John Locke, labor theory of private property, privacy, social contract theory	American Marketing Association
9	Privacy Concern and Online Personalization: The Moderating Effects of Information Control and Compensation	David G. Taylor, Donna F. Davis, and Ravi Jilapalli	2009 USA.	Empirical Study—394 university undergraduates	Privacy concern, Personalization, Information control, Compensation, Implicit data collection, Online trust	Electronic Commerce Research
10	Subjectivity and Information Ethics	Bernd Frohmann	2007 Canada	Conceptual Study	Ethics, Information Ethics and “Modes of Subjectivation”	Journal of the American Society for Information Science and Technology
11	Gaining Trust Through Online Privacy Protection: Self-Regulation, Mandatory Standards, or <i>Caveat Emptor</i>	Zhulei Tang, Yu (Jeffrey) Hu and Michael D. Smith	2008 USA.	Conceptual Study	Consumer information, consumer surplus, Internet, privacy, social welfare, trust	Journal of Management Information Systems
12	Internet Users' Information Privacy-Protective Responses: A Taxonomy and A Nomological Model	Jai-Yeol Son and Sung S. Kim	2008 USA.	Empirical Study—523 Internet users	Information privacy, responses to information privacy threats, information privacy concerns, ethical issues, structural equation modeling, causal model	MIS Quarterly
13	The Ethics of Online Retailing: A Scale Development and Validation from the Consumers' Perspective	Sergio Roman	2007 Spain	Empirical Study—153 observations from a southeastern university in Spain for scale development, 209 responses for second phase	Consumers, ethics, Internet, retailing, satisfaction, trust, scale development, ethics of online retailers (CPEOR), satisfaction, privacy, security, non-deception, fulfillment/reliability,	Journal of Business Ethics

SQ	Article	Authors	Year Country	Sample	Keywords	Journal
14	Do Ethics Matter to E-Consumers?	Avshalom M. Adam, Avshalom Aderet, and Arik Sadeh	2007 Israel	Empirical Study—120 E-consumers (110 of them are MBA or MSc graduate students)	E-Commerce, ethics, privacy, fair business practices, security, commercial factors (product price and quality) & ethical factors (accurate product description, security, e-vendor accountability and assuring e-consumer privacy)	Journal of Internet Commerce
15	E-Commerce and Information Privacy: Privacy Policies as Personal Information Protectors	Corey A. Ciochetti	2007 USA	Conceptual Study	Privacy, security, privacy policy, a new law, PII	American Business Law Journal
16	The Ethical Dilemmas and Challenges of Ethnographic Research in Electronic Communities	Neil Hair and Moira Clark	2007 USA, UK	Conceptual Study	Ethical Dilemma, Virtual Ethnography, Electronic Community	International Journal of Market Research
17	Customer Privacy on UK Healthcare Web sites	Darren P. Mundy	2006 UK	Conceptual Study	Privacy, goal-oriented analysis, data protection, cookies, privacy protection goals, privacy vulnerability goals	Medical Informatics and the Internet in Medicine
18	Privacy Rights on the Internet: Self-Regulation or Government Regulation?	Norman E. Bowie and Karim Jamal	2006 USA.	Conceptual Study	E-commerce, regulations, privacy policy, privacy seals	Business Ethics Quarterly
19	Pop-Ups, Cookies, and Spam: Toward a Deeper Analysis of the Ethical Significance of Internet Marketing Practices	Daniel E. Palmer	2005 UK	Conceptual Study	Pop-ups, cookies, spam, e-commerce, marketing ethics, privacy, property, autonomy	Journal of Business Ethics

SQ	Article	Authors	Year Country	Sample	Keywords	Journal
20	A Typology of Communicative Strategies in Online Privacy Policies: Ethics, Power and Informed Consent	Irene Pollach	2005 Austria	Conceptual Study	Cookies, critical linguistics, data-handling practices, e-commerce, information privacy, language, privacy policies, trust, Web sites	Journal of Business Ethics
21	Is There a Special E-Commerce Ethics?	Beverly Kracher and Cynthia L. Corritore	2004	Conceptual Study	Features of e-commerce, ethical rules, e-commerce ethics	Business Ethics
22	Strategic and Ethical Considerations in Managing Digital Privacy	Ravi Sarathy and Christopher J. Robertson	2003 Netherlands	Conceptual Study	Precursors (National History & Culture, Global Societal Trends), External Factors (Existing and Pending Legislation, Importance and Sensitivity of Data), Ethical Philosophies, Firm-Specific Factors, Economic Benefits, Cost of Compliance	Journal of Business Ethics
23	E-Commerce, Ethical Commerce?	Mary D. Maury and Deborah S. Kleiner	2002 Netherlands	Conceptual Study	E-Commerce, ethics, Problems regarding financial reporting, intellectual property and privacy	Journal of Business Ethics
24	Ethical Issues in Electronic Commerce	Bette Ann Stead and Jackie Gilbert	2001 Netherlands	Conceptual Study	Conflict of interest, cookie file, cybersquatter, dinosaur behavior, disintermediation, extranet, fraud, mass customization, privacy, spamming	Journal of Business Ethics

According to Maleki and Akbarzadeh Pahsa (2012), there are many aspects of ethics that can affect e-commerce systems, but perhaps the most notable and worrying to both consumers and developers are that of trust. In their paper, they discussed some of the ethical challenges in electronic commerce and offered the possible solutions that can encourage developers to consider ethical considerations and prove excellence and trust to the consumer. Tan and Tan (2012) investigate corporate social responsibility (CSR) issues in the digital communications industry that is pertinent and require further attention, and they track Google's experience in China, both to explore its strategies and to consider the implications for corporate social responsibility. Anday et al. (2012) aim to explore the literature on security issues that digital libraries should consider in managing digital resources in their study. Nishihara (2012) reports on a survey-designed study that empirically investigates the relationship between environmental and individual traits leading to the practice of ethical behavior within a marketing firm. Drawing upon extant ethical constructs, and using both the General Theory of Marketing Ethics and Social Cognitive Theory as guides, he finds strong support for the potential synergy between individual tendencies and firm characteristics in order to facilitate ethical behavior on the part of marketing employees.

The purpose of Sipior et al.'s study (2011) is to examine Web users' privacy concerns associated with the Web-tracking and information-gathering technologies, including cookies, Flash cookies, and Web beacons, which offer marketers the opportunity to collect a wealth of consumer information. The study of Williamson et al. (2011) seeks to offer insights into the Internet ethics of college students, a major category of Internet user, by using the Multidimensional Ethics Scale to explore students' perspectives on questionable Internet practices involving privacy, accuracy, property, and accessibility (PAPA) issues. Yang et al. (2009) investigate the effect of shopping Web sites' perceived ethical performance on consumer trust with an empirical study. The variables are shopping Web site's ethical performance, shopping Web site's perceived ethical performance, trusting belief, trusting intention.

In the paper, Hettche (2009) considers the issue of Internet privacy from a normative marketing ethics perspective and outline a Lockean theory of Internet consumer rights. He argues, in particular, that the surveillance of consumer Internet activity without proper consent is a violation of a consumer's "virtual property rights." The aim of Taylor et al.'s empirical study (2009) was to explore the potential moderating effects of compensation and information control on the relationships between trust, privacy concern, and behavioral intentions in the context of personalized online interactions. Frohmann (2007) proposes some answers by investigating the meaning and role of subjectivity in information ethics. Some the questions are explored by directing attention to autonomous and authorless information processes that bypass consciousness, and to how they are involved in the construction and deconstruction of modes of subjectivity.

Tang et al. (2008) develop analytic models of hidden information to analyze the effectiveness of these regimes to build trust and their efficiency in terms of social welfare. They find that firms' ability to influence consumer beliefs about trust depends on whether firms can send unambiguous signals to consumers regarding

their intention of protecting privacy. The paper of Son and Kim (2008) contributes to researchers' theory-building efforts in the area of information privacy by breaking new ground for the study of individuals' responses to information privacy threats. Roman (2007) develops a reliable and valid scale to measure consumers' perceptions regarding the ethics of online retailers (CPEOR). Adam et al. (2007) investigate the extent to which ethical factors impact consumer willingness to purchase from e-stores. Two commercial factors (product price and quality) and three ethical factors (assuring e-consumer privacy and security, guaranteeing e-vendor accountability, and accurate product description) are examined in the context of a hypothetical purchasing situation.

Ciocchetti (2007) offers a solution to privacy protection problem by proposing a new federal law designed to make electronic privacy policies more effective. The purpose of Hair and Clark's paper (2007) is to raise the awareness of a range of ethical dilemmas and challenges facing researchers who adopt ethnographic approaches in electronic community research. The aim of Mundy's research (2006) has been to analyze privacy policies on popular UK healthcare-related Web sites to determine the extent to which consumer privacy is protected. Bowie and Jamal (2006) conclude that the use of assurance seals has worked reasonably well, and Web sites should be free to decide whether they have a privacy seal or not. Given the narrow scope and the wide variety among these seals that the seals should commit themselves to the key features of a good privacy policy and that an opt-in provision be required are discussed in the paper. Palmer (2005) discusses that the ethical issues surrounding these Internet marketing techniques move beyond the traditional treatment of the ethics of marketing and advertising found in discussions of business ethics previously. Pollach (2005) examines privacy policies from a linguistic angle to determine whether the language of these documents is adequate for communicating data-handling practices in a manner that enables informed consent on the part of the user. Kracher and Corritore (2004) examine and compare the ethical principles and rules demonstrated in e-commerce and brick-and-mortar business. Sarathy and Robertson (2003) set up a framework in their study which incorporates the environmental context, ethical perspectives, and firm-specific considerations to help firms develop a strategy for handling digital privacy concerns. Maury and Kleiner (2002) look at the new frontier of e-commerce, the ethical challenges it is facing and discuss some of the problems encountered and some of the solutions that are evolving. Stead and Gilbert (2001) review the incredible growth of e-commerce and present ethical issues that have emerged.

### 10.3 Conclusion

E-commerce, as a new medium of communication, makes the commerce more convenient and comfortable for both customers and merchants via providing more useful information, expanding choices, simplifying purchasing processes, and lowering costs (Maleki and Akbarzadeh Pahsa 2012). The emergence and growth of e-

commerce bring with it a host of ethical questions. E-commerce ethical issues are, in fact, not unique but that the ethical issues in e-commerce are different from those in traditional commerce with respect to manifestation and scope. The top ethical issues in e-commerce can be summarized as access, intellectual property, privacy and informed consent, protection of children, security of information and trust. It should be taken into consideration that there are many different facets and dimensions to consider when analyzing this topic. The results of these reviewed studies here point the importance of privacy concerns and ethical challenges which are significant determinants of e-commerce business success. Recommendations of these papers provide specific guidance to e-commerce Web site operators concerning the importance of privacy policies and their implications in order to confront the consumers.

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# Chapter 11

## Ethics in Finance in Emerging Markets



Bogdana Vujnović-Gligorić, Sanel Jakupović and Vedran Šupuković

### 11.1 Introduction: Ethics and Morality in Contemporary Social Environment

In terms of globalization and increasing dynamism and openness of economic subjects, the need for a high degree of confidence is expressed. Right here begins the link between economics and ethics. Lack of ethical standards in business operations harms the company, and then, the damage transmits to its business partners from different countries and ultimately to their national economies. Given that the country achieved a high degree of liberalization in the area of capital movements, which carries with it the greed, then there is a strong need to prioritize the study of ethics in finance and boundaries that define what is moral and what is immoral in finance. Determining these limits becomes a challenge and for managers and employees. Boundaries of ethics are often subjective evaluation that depends on the moral integrity of the individual, cultural heritage, the pressures, and expectations of the company and the environment.

Ethics (Greek: *ethos*—custom, usage, or character) is a branch of philosophy that studies the moral behavior. It is defined as a set of moral principles of a conduct, known as the code of moral conduct. The task of ethics is to comprehend morality, basic components of moral, and to take critical stance toward the ruling moral practice. Therefore, ethics should indicate different views of people, assess values, and indicate the true human values. The subject of ethics is value judgments

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and ethical practices of mutual relations in society, i.e., dealing with employees, shareholders, unions, customers, and the public at large. Ethics explores value attitudes of employees and their actions and makes proposals for the ethical rational behavior of individuals.

In the world of business, ethics is important for making moral decisions, i.e., decisions that are based on a rational basis. The essence of the study of ethics is to enable an individual to justify his ethical choices based on solid ethical principles. Ethics in business is intertwined with morality. Morals (Latin: *mos, moris*—lifestyle or treatment) are tied to a personal conduct and often religious belief. When the two moral constraints conflict with each other, then by help of ethics we apply rationally valid principles. That's why ethics balances each opposing answers that are not "true." For example, the pressure on the worker to plead guilty of a colleague requires that he scales up between two moral values: loyalty to colleague and devotion to the truth. Due to the influence of a big number of ethical signals, the clash of opposing values occurs. In order to resolve these conflicts and to facilitate difficult ethical choices, we need to study ethics and moral reasoning.

Ethics and morality are related to each other as the theory and practice. Therefore, morality can be defined as a form of human practice or practical man's relationship to the world, to other people, as well as himself. Morale is manifested in assessing the value of human actions as good or bad, desirable or undesirable, approved or disapproved, etc. For any assessment of moral judgment, it is necessary that there are criteria in the form of standards or rules laid down by society or a particular authority.

Business ethics was popularized in recent years because of inhuman relations of capital owners, illicit ways of exploitation of employees, as well as the unethical actions of employees who inflict great harm to employers. In addition, through business ethics we can help improve the company's reputation in the public.

Ethics at the enterprise level deals with ethical issues setting the framework conditions of business, which aims to provide equal opportunities for all participants, i.e., that all participants are provided with the same chances of success. From a moral point of view, it is necessary to ensure a fair relationship in which no one would have been privileged to have an advantage over others. The lack of moral control in operations leads to rising costs and losses, which reduces the competitive advantage of company and undermines its reputation in society (Greuning and Brajević 2006).

## 11.2 From Business Ethics to Financial Ethics

On the way of growing financial ethics from business ethics are some important considerations, such as theological articles on financial ethics, contributions of modern economic theory, thinking about human rights, etc.

Contributions of theology concern the attitudes of interest as moral or immoral act. In addition, theology raises the question of enrichment, especially in illegal transactions, as well as the question of acquiring money without work, i.e., on the basis of investment activities. Modern economic theory does not rely only on profits, as the sole reason for existence. Economy and finance must be based on the principle of economic rationality, taking into account the consequences of their decisions and activities on society, the environment and key participants. Finances are not just transactions, but also include working with clients. On this basis, the financial ethics with its conceptual, substantial, and methodological aspects of content cannot be equated with business ethics, even not with traditional financial ethics.

Contemporary finances are highly mechanized and sophisticated and in large part dehumanized. Traditional finance has implied encounter of financiers with a client, not the financier and the client as two autonomous entities that develop partnerships. Contemporary financial ethics must maintain continuity with traditional ethics, but it is important to expand and modernize it. Modern financial practice is becoming more demanding. It is difficult to subsume it under humane because it is interwoven with many elements of techniques.

Contemporary finances focus on the client. Scientific and practical training of financial professionals and employees in finance is directed to acquiring the ability to communicate with the right customer and the ability to negotiate and take responsibility. Traditional unwritten code of financial ethics is transmitted from teachers to students and is characterized by competence, diligence, integrity and conscience, as well as fairness. Globalization of financial markets leads to complex situations that require professional ethics. For it, the financiers will be enabled only if they are presented with ethics professionally and continuously. Ethics are still considered marginal and unfortunately, and it is accepted that way.

Development of finances leads to changes of the social situation that is characterized by:

- Clients who increasingly emphasize their autonomy and rights,
- Decisions on financial transactions are increasingly made through a partnership between a client and the financier,
- Setting values and moral standards in society is very heterogeneous.

Regardless of the fact that in a society there is no unified approach in setting values and moral standards, ethical decisions must be made in an ethically correct and responsible manner.

Financial experts are no longer wanted to just take care about transactions, but also to take preventive measures to improve the financial health and enterprises and business partners and customers. This is made possible with the great advances in the knowledge of risks, creditworthiness assessment, as well as advances in preventive

measures, before and after the execution of a particular job. Modern scientific and technical capabilities have clarified the causes of certain risks, to overcome problems arising in a bankruptcy as well as the consolidation of existing problems without major consequences. The customer is the center of interest; he should be offered with opportunities, assisted in the selection, and allowed to use the after sales service, and the company should monitor his intake services. The financier must always apply good methods in order to make a good assessment of the financial health of the client. He then must choose the appropriate product/service for the customer. In the work of financiers are solid fences and framework conditions, but the final decision is made together with the client and other participants in the financial transaction. Most of the decisions in working with clients are based on estimates, assumptions, and perceptions. Power estimates cannot be deduced from any rules and regulations. Assessment is fended to itself and cannot be learned, but can only be achieved through experience. Therefore, finances are more practical discipline and financial ethics applied discipline. The client must be viewed in their lifeworld. A special task of financial ethics is to identify contemporary financial problems and to pervade them with ethical thinking.

In emerging financial markets, it is still expressed lack of business ethics of individuals, participants in financial trading. An individual who does not have built personal key principles of business ethics nor possesses the moral standards is ready to abuse by putting his personal interests above the collective, legal, and social norms of business ethics. Thereby, he disrupts the business climate and creates distrust in others. Given that the ethics of the individual is a building block of corporate ethics, then it is understandable that an individual with poor ethics becomes malignant point in company's business, with the danger of being extended to the entire enterprise.

In practice, there are often morally problematic situations that are difficult to resolve properly. Such ethical dilemmas are present in the staff and the managers. Employees in such situations review their rights, duties, and responsibilities and usually try to direct decisions in their personal interest.

Violation of business ethics by employees in finance is mainly done through the following actions:

- Bribery,
- Adjustment of expense,
- Nepotism,
- Theft,
- Negligence and arrogance,
- The theft and sale of confidential information, etc.

Managers are exposed to different types of dilemmas, such as:

- Fiddling the financial statements,
- Giving false information on financial products/services,
- Breach of contract,
- Enter into contracts with dubious business partners,
- Conflict of interest,

- Adoption of unrealistic business policies and plans, who in case of failure justify themselves with false facts,
- Weak loyalty to the company, especially in conditions of poor business,
- Poor quality of financial products,
- Humiliation of subordinates,
- Submission to authority,
- Engagement in high-risk operations, etc.

The fundamental question that arises in solving those ethical problems is how, from a number of options, to choose the solution with the highest level of morality. A guideline for commitment is in finding the norms of good management, that is, waste where the main goal is not economic rationality (profit at all costs), but is also concerned about the consequences of business activity for the company, the environment, and the participants. So, the effects must ensure lasting and quality life in a country. For hard-to-solve problems, Ethics Committees can be engaged, which may help in deciding.

Problem in ethical decision-making is increased by the fact that there is no identity between the personal and business ethics. Individuals behave differently when deciding in private life than in company or environment. Individual's personal values disappear when an individual finds himself in a situation where he should decide on the issues of distribution of money, power, or position, where you have other types of benefits. That's why people in power are more exposed to moral dilemmas and challenges to make mistakes at the expense of others. If they make the decisions that benefit them and their friends, then the question which arises is whether the environment derogates morals, bringing the need to get out of a moral framework or an individual who had tendency to low business morality or the successful combination of both.

### 11.3 Financial Ethics

Historical perspective of the origin and development of emerging financial markets talks about awakening of ethical consciousness. In created civilized circumstances threats of economic destruction of individuals, human degradation to the lowest level of dignity (through manipulation, exploitation, experimentation, and destruction) is expressed. John Costa said that the business world is full of scandals from shops, banks, insurance costs to fake managers (Costa 1998). Financial ethics or ethics in finance deals with study of moral dilemmas arising from the specific financial practice. Financial ethics, as an interdisciplinary science, should focus on solving

moral problems caused by financial and general scientific–technical activities. Consequently, if you would like to define financial ethics, then the appropriate definition of financial ethics would be systematic study of human behavior in the area of finance, in light of the moral values and principles. For the application of financial ethics, it is needed to define a system of moral–ethical values as the proper standard of human behavior and to teach how to use the knowledge, especially financial, for economic survival. Also, the awareness of the need for its application in the field of science and related practices is important.

The choice of the model and content of the financial code of ethics is influenced by numerous factors, such as achieved level of development of financial markets, the degree of liberalization, democracy and development. In addition, it is necessary to answer the questions: who to include, how, when, and who forms the codes?

From the aspect of the subject of inclusion, we discern general from the specific financial ethics. General ethics refers to the whole society and the need for the whole society to accept a critical awareness of the importance of the issues by the internationalization of financial market and is related to knowledge of finance and financial health. Financial ethics should be directed toward those who will work in finance, regardless of expertise and qualifications. Consumers of codes of financial ethics are also people from other professions, such as politicians, lawyers, psychologists, and all those whose work touches on finance from different perspectives.

The answer to the question of how to establish the codes requires starting from the general to the specific and the theoretical—practical in the cognitive applicative field. Area of knowledge does not imply strictly and knowledge, but “soul” in order to implement the understanding into action.

The question that often arises is when do you establish ethics in finance? Opinions may take on different dimensions, since its adoption in kindergarten to her research in practice and at university. More acute financial bankruptcies are saying that the financial ethics should be learned at an early age.

And finally, there is the question of who forms the financial codes of ethics? General ethics in finance requires interdisciplinary when created, while specific codes include more specialist knowledge, although information from other disciplines are indispensable.

Ethics in financial trading should be much more advocated and practiced in transition countries. In these countries, the obvious problem is operations on non-economic criteria, so it is hard to tell what is normal and desirable and what is undesirable and harmful. Non-market operations are reflected in an excessive reliance on political subjects in business, lack of transparency in the privatization and sale of state-owned enterprises, the state capital spillovers into private hands through onerous contracts, frauds on the market, the pressures on public tenders and auctions by political structures or influential individuals, etc.

The desire for profit and acquirement of advantage in the market, as well as for personal use, impacts that individuals and groups abandon established rules in order to gain competitive advantage (Francis 2000). If some information about the business is hidden which may give priority competition, then it is not a violation of the ethical conduct of business rules. But if the boss is using some inside information and sells

his shares before they experience a decline, then he was out of the scope of the business ethics, but he did nothing illegal. All this suggests that ethics and profits cannot go together. To achieve business success, in terms of the stiff competition, the use of various forms of hidden deceptions and lies becomes inevitable. The question now is to determine the limits of business ethics in such situations. Setting limits is a matter of personal decision, our moral integrity, our own experience of a situation, interests, needs, motives, the question of cultural heritage, the pressures coming from the environment, etc. The limits should be within the established norms and rules, as part of good business relations and habits, as well as in the limit of personal positions and situations with respect to those with whom we enter into a business relationship. According to Albert Carr, cheating and lying is morally justified as long as it is in the limits of the unwritten (common and implied) rules of business and market games (Carr 2001).

### ***11.3.1 The Complexity of the Relation Between Ethics and Finances***

Relationship between financiers and users of funds in the financial markets becomes the basis of moral issues. This relationship is viewed as faithfulness of financiers and users, as well as the value of the human person, and is constantly evaluating the relationship. Such a relationship requires personality setting of finance.

The user of beneficiary funds, the client, is responsible for his financial health, and his commitment is to protect his standard through care of the finances. Although he has absolute power to arbitrarily control the finances, his conscience dictates that management must be responsible for economic existence. The financier is an expert, who client chooses to give him support in addressing certain financial situations. Its mission is to provide quality service. Consequently, the client is the main mediator in the care of his financial health. The relationship of cooperation between financier and the client is of subsidiary character and in the limits of autonomous responsibility. This is why it stresses the importance of dialogue between the financier and the client. Dialogue puts two good consciences before the good that exceeds them: financial health of the client and the person with all the values. That dialogue is moral; it is needed to have the following objectives: information, financial treatment, and decision-making. The relationship between the financier and the client is by nature complex because diagnosis and treatment depend on subjective factors. Problems arise when one or both parties do not comply with the agreed or when a client loses confidence to funders who catered him. The problem is often dealt with the authority of financiers, which negatively reflects on mutual trust. In this case, the financier would give measured information to customer in order to lead him to do something on his own behalf, despite the fact that the client is not ready at the moment. In the interests of a client in some cases, specific information is not told and the truth is manipulated without the consent of the client.



Unlike models of authority, in the model of autonomy, financiers act becomes positive, not because it achieves a good customer, but it comes from the client's free choice. Information needs to help a client to make an easier decision, even if that choice is not reasonable. The financier cannot do anything without the consent and will of the client. Therefore, for the establishment of financier's act, from an ethical point of view, it is needed to take into consideration:

- Good customer,
- Consent of both parties to the transaction,
- Legal recognition as a guarantee of legality, moral requirements,
- Relationship models financier—the client.

Relationship financier—client is not simple, and it is difficult from the viewpoint of moral reasoning subsumed under these two models. With increasing financial problems increases the number of models. The practice also knows parenting model, which assumes the existence of objective factors in determining what is good for the client, so that it is easier for the financier to make a decision. The financier has the role of guardian of the client, and its decisions have the advantage over the autonomy of the client. Such a model could be applied only in urgent and exceptional cases. In normal situations, this model should not be used as an ideal model.

Unlike the parenting model, an information model requires interaction between financier and the client, so that the financier could collect all the information related to diagnosis, treatment, and mutual risks. Based on the information gathered, with the consent of the client, financier can perform the necessary activities. Finally, the interpretative model requires the financier to help the client to reflect his values and give the significance to his own choice. So, financier by using information about the risks and benefits of individual services helps customers to select specific services of better value.

Each of these models represents a conflict to be resolved in favor of self-determination of the client and its autonomy as an absolute value. If the choice of the client is not in accordance with his best interest, the financier should not abstain but encouraged to seek a good opportunity for intervention to the client, so that the client can secure his gain and restore his autonomy.

### ***11.3.2 Ethical Aspects of Modern Finance***

Responsibility of participants in the financial market is regulated by the general and special rules. By general rules, it regulates the responsibility of all participants and by the special responsibility of professional participants, such as brokers, dealers, investment advisers, banks, issuers of securities, and other.

With time changed and the ethical constraints and with them the moral criteria of individuals. Sometimes, for example, brokers who were underpaid for their work would receive gifts, while still looking at them with a touch of contempt. So, it is difficult to determine the ethical boundaries and establish a unified position on moral or immoral.

Important components of ethical behavior in the financial market are defined moral values and attitudes. Basic moral values in finance are objectivity, honesty, and trust. Realizing the true human values and setting the rules can help to more easily distinguish well from evil, because the famous adage says “What is not prohibited by the law may be prohibited by the embarrassment.” However, the erosion of the moral dimension has led that greed and fear (to miss an opportunity, nobody is quite sure) have become the main drivers of the financial markets. Instead of moderation and safety, morals, faith, and diligence, financial markets rely on greed, fear, judgments, selfish interests, and profits.

Today’s developments in the financial market are similar to satire of Pope Alexander VI, when his disciples and Cardinals asked: What should we do to be saved? Pope Alexander VI replied to them: “Why do you ask me? The law is written and I say to you: love the gold and silver all thy heart and with all thy soul and love the rich as yourself. So you do and you will be fine. And Pope sits on his throne and said: Blessed are those who have, because they will see my face; blessed are those who are brought, they will be called sons of mine; blessed are those who come in the name of gold and silver, because their curia is papal. It would have been better to give the poor who comes to me empty-handed obese stone mill on the neck and to push them into the sea. Cardinals answered: We will do it! And the Pope said: “Children, I give you an example that you like me; rob from the living and from the dead!” (Mereškovski 2010). If money becomes the only value system, there is a danger that the basic ethical principles in the finances are relativized and ignored.

Rules of ethics in finance in emerging markets are determined in order to protect investors, savers, and depositors. Ethics in financial markets involves the application of ethical principles to achieve an appropriate level of financial morality and fairness and integrity of its participants. In that case, the financial morality, fairness, and honesty should have dominance over the immorality, lies, deceit, and fake participants in financial markets. More financial ethics reduce fraud, bribery, and corruption. Contemporary theories and practices want to grasp the causes that lead to discrepancies in the application of ethical principles and then to the financial crisis and fractures.

The most common causes of crises resulting from the weakening of ethical values in the financial market are cited as:

- Dishonest monetary and banking system,
- The appearance of a paper and electronic money,
- Ignorance and misconceptions.

Ethics and morality in the financial market are introduced through legislation, usually in the form of ethical norms. Given that financial markets integrate into the international, it is necessary to harmonize national legislation with international and to coordinate their activities with foreign policy. However, it is not an easy job because of the heterogeneity of the financial markets.

Modern financial markets are characterized by varying the intensity of the following events:

- A general decline in the value of money and securities,
- A shortage of capital,
- The erosion of respect for law and business ethics,
- Social irresponsibility (in compliance with the regulations, the social protection of human rights, environmental protection, etc.),
- Wealth without work and commitment,
- Rapacity and lack of compassion,
- Regular stock market crash,
- Financial crisis, etc.

On such a confusing financial market is necessary the harmonization of regulation. The control is still of a regional character, but on a large extent dependent on international standards (BCBS, IOSCO, IAIS, CPSS)<sup>1</sup>. The goal of harmonization is to avoid regulatory arbitrage, increase competitiveness, and reduce differences in the regulation of products. However, it is difficult to standardize regulation of all market activities, especially when the changes in the financial environment were driven by liberalization, which operates with free-market forces. In order to ensure equal treatment and protection of rights of investors; savers and depositors (owners of money) in addition to numerous legal mechanisms use special codes. In highly developed countries, codes are becoming more the norm. Globalization calls for the inclusion of ethical behavior in business of other countries.

### ***11.3.3 Basic Principles of Financial Ethics***

The quality of financial ethics depends on the quality of the natural behavior of participants in financial markets, as opposed to others. Participants in financial markets are guided by their own interests to make profits. The moment when the interests are feasible and mutually acceptable, a market price is formed. In such conditions, it is necessary to incorporate, in addition to legal norms, appropriate ethical values. Basic principles of financial ethics are:

- Mutual trust of the participants,
- Expressed benefit and interest of all participants in the agreement,

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<sup>1</sup>Basel Committee on Banking Supervision (BCBS), International Organization of Securities Commissions (IOSCO), International Association of Insurance Supervisors (IAIS), Committee on Payment and Settlement Systems (CPSS).

- Good intentions,
- Willingness to compromise and tolerance,
- Willingness to losses due to bad decisions,
- Harmonization of individual and common interests,
- Equality of partners,
- Price must be satisfactory for the participants,
- Autonomy in decision-making,
- Approval of the transaction,
- Equity in relation to each client.

Mutual trust means real respect of equal individual and collective rights. In the absence of moral values, the mutual trust is reduced. Trust must be built because it is becoming a crucial factor, not only for restoring individual transactions, but also for the survival of the financial markets. Practice has proved that the lost trust, relating to financial transactions, is difficult to recover. The best example of this is the countries in transition and it took them a long time to convince the depositors in the safety of savings in the privatized banks. Trust is hard to build especially in electronic transactions, where transactions are conducted without the presence of the parties and without insight into the subject of the sale. In order for such transactions to be conducted, between participants must be mutual trust and confidence in the financial system. Trust is now one of the key requirements for a successful business. To a loss of confidence comes in the case of fraud or expressed intent to commitment of fraud. The bigger and bigger the need for trust is that it expands opportunities for fraud and other malicious business activities. If we add to this the lack of business tradition, undeveloped codes of ethics in business, and destroyed system of values, then it is understandable why the number of business scandals and fraud increases.

Mutual benefit and interest is one of the key factors linking business partners. If one side is damaged, the transaction is not considered to be fair and correct, but the transaction under coercion, blackmail or for an necessity. Such transactions are usually one-off character and have no significant impact on financial ethics because they are largely of voluntary nature. The basic requirement of the principle of mutual benefit and interest is that none of the participants should feel cheated. In other words, the client should be offered those products/services which he accepts and which won't harm him and from which he would benefit, while being satisfied on the other hand. The problem in the financial market is to reconcile conflicting interests and demands of making profits and that it takes place within the limits of business ethics. This requires a kind of wisdom from participants' transactions. Only "a wise businessman seeks advantages to the extent that does not create animosity among employees, competitors, customers, the government and the entire public" (Carr 2001).

Principle of good intention requires that the partners come forward in good faith toward each other. In business terms with imaginary goods, on the virtual markets, it is important that the partner believes that the other parties will not deceive or mislead him. If there is a good intention, there are fewer opportunities for fraud, damage, or other types of immorality.

Business compromise and tolerance are related to the individual's moral principles. Although the compromise means accepting other requests at the expense of your own, in finance compromise must be reasonable and that means that each participant realizes the greater real benefit than the potential. For such an agreement, there must be a spirit of tolerance and balance on both sides, in the naturally opposing interests (interest of the customer to buy it cheaper and the seller to sell it the more expensive).

As a result of bad decisions losses occur. Of great importance is that the affected party properly assesses the cause of the damage, so that it won't attribute blame to the opposite side. This will create a positive ethical image with another party that started with good intentions, with respect for the principle of compromise and tolerance.

Difficulties in aligning individual and common interests are mainly present in emerging financial markets. It is important to be aware of what are the common interests, although each participant contributes in its way to achieving them. This does not mean that the individual interests are not important, but that they should not require an undeserved interest. In practice, it is difficult to connect these, often conflicting, interests because they do not use the same ethical norms and values.

All participants in the financial market should have equal status. Access to information must also be equal, which is reflected by the openness of all participants. Serious ethical problems arise when participants in the financial markets, and especially joint stock companies and brokers, make and shape information inaccurate or dimmed in order to deliberately manipulate suspicious contents, to lure investors to invest.

Central place in the financial market is the problem of determining fair prices. Fairness of prices is an ethical issue. Price is unethical if the same product/service is sold at unequal rates to different clients, often with the intent to damage or remove competitor. Also, unethical behavior is when a financially stronger side raises or lowers rates, with the clear purpose to inflict harm or destroy the weak side.

The principle of autonomy requires respect for freedoms of others, as well as their decisions. In finance, it means that the banker and financial agent must respect the decision of the client first and foremost, who must be informed of the conditions and criteria for the provision of financial products/services. For each transaction is required to provide consent of the client by providing his signature on the document. The principle of fairness obliges bankers and financial intermediaries to relate to each client in the same manner and to provide recommendations according to objective, not subjective facts.

The rules of behavior, determined by the above principles, must be constantly improved in order to enhance the professionalism and conduct of business in the financial market, ensuring its safety and security. It is also a way to protect the participants of the competition in the financial market, especially those acting in unprofitable market principles.

## 11.4 Mechanisms to Preserve Ethical Values in the Financial Market

The participants in the financial market are required to abide by the principles of financial ethics. They are obligated to do so by law and normative acts by which is regulated business activity. Financial markets must be developed on compatible principles of European Union. For the success of the financial market, it is necessary to favor the regulated market versus anarchic, disciplined versus corrupt, standardized versus improvised, easily controlled versus lump sum taxed, etc.

Keeping healthy financial policies is essential for protection against the spread of financial contagion. Natural regulation of market materials and ethical values is done in the form of financial product standardization and codification of ethics. It is also a way to preserve ethical values in financial trading. Standardization of financial products is a procedure for determining and prescribing uniform solutions in the design, manufacture, and sale of financial products over a period of time. Standardization helps to increase confidence because it motivates the application of ethical values and principles. Thanks to the standardization of financial products, visual advantages are obtained, such as:

- The immoral behavior of participants is discouraged, and unethical occurrences are eliminated (lies, deception, etc.),
- Blurred transaction are prevented,
- The carriers of immoral phenomena are identified and sanctions against them are imposed,
- The transparency of financial transactions is enabled, etc.

Implementation of standards becomes inevitable on an integrated financial market. Simplified communication with investors is the foundation for attracting capital. The standardization process involves stakeholders and regulators of financial markets: International Monetary Fund, the World Bank, the OECD (Organization for Economic Cooperation and Development), and Basel Committee, a forum for financial stability, investor associations, and unions. Based on the knowledge and experience of these institutions, it is necessary to establish standards to ensure safer and more efficient activity of the financial market, while preventing the occurrence of crises and their spread. Often, the question of the legal nature of standards arises. Their legal character is reflected in the following:

- In most cases, the standards are not legal norms and therefore not binding,
- Obligation derives from the authority of decision and market logic,
- Standards are normative concepts that change the contents of each individual case, but remain the same (relative judgments of characters),
- They are more important than laws and regulations,
- Standardization was carried out in all key areas: corporate governance, accounting, auditing and banking supervision, insurance, operations with securities (IOSCO),
- Every investor wants to obtain information whether the particular market and organization implement the standards, what is the firmness of the institutions,

how big is the power of the legal system, whether it is supported by information transparency, etc.

The ethical standards of professional conduct of the participants in the financial market are, in fact, the code of the financial ethics. The duty of financial market actors is to follow professional and ethical principles prescribed by the code and to oppose to pressures to break them.

Attempt of mediation of principles established by positive-legal regulations and ethical principles is done through the codification of ethical standards. Codification of ethics in finance is done through codes of ethics. The meaning of the codification of moral principles is that the ethics of the financial market participants complies with generally social morality and that simultaneously finance, according to their specificities, forms a special ethics which is not identical to the ethics of the wider community. Even within the various sectors of finance, there are so many ethics that may vary.

Codification involves the adoption and practical implementation:

- Code of financial ethics,
- Insider rules, and
- Financial–market regulations.

Code of financial ethics includes the prescribed norms opting morally acceptable behavior of participants in the financial market in the performance of their professional duties.

Insider rules are formed for the purpose of regulating the trade of financial instruments on the basis of inside information. Financial market activity is regulated by a set of normative legal rules, measures, and instruments. Total financial–market regulation includes:

- Regulations concerning the status form of the institutions of the financial market, the form of organization, the requirements for inclusion on the financial market, the revocation of the license to operate in the financial markets, the misuse of information, etc.
- Regulations relating to the regulation of conflicts of interest, incompatibility of functions, responsibilities of actors in the financial market,
- Regulations concerning the selection of the optimal standardization of financial products, product creation, and marketing of selected products,
- Regulations concerning the rules of operating performance and technical standards,
- Regulations concerning the rules of conduct of the participants in the financial market, and
- Regulations related to the creation and application of tariffs.

### ***11.4.1 Financial Code of Ethics***

Ethics and moral integrity must be a guideline in the financial operations of each entity. Doing business with strong moral integrity of management and employees is essential to building confidence and gaining credibility with customers, business partners, shareholders, and others. Leading framework for such operations should be financial code of ethics as part of the general business codes. Last year we started with the establishment of codes of ethics in the business world, especially in emerging financial markets.

Financial Code of Ethics should provide promises of honesty, fairness, and transparency in business, especially in communicating with participants in the financial market.

Managers are required to maintain good relationships with investors, customers, creditors, employees, etc., in accordance with prescribed standards at the highest level.

Prescribed standards became an obligation and responsibility of all employees in the organization. They are obliged to respect the ethics and avoid situations that entail any conflicts. Conflicts of interest must be declared. Financial Code of Ethics should contain rules on an individual and collective responsibility and accountability to all stakeholders. Such responsibility includes:

- Compliance with applicable laws, rules, and regulations,
- The protection of confidential and proprietary information,
- The protection and proper use of assets, particularly financial,
- Resolution of conflicts of interest,
- To promote and report unethical or illegal behavior,
- Respect for human rights in all financial operations,
- Fair, understandable, and timely disclosure of information about the business and other public announcements.

#### **Compliance with laws, rules, and regulations**

Compliance with laws is related to all aspects of the business and all stakeholders in the business operations. Employees must be familiar with the applicable regulations in the fields of international affairs, trade securities, accounting reports, anti-monopoly, etc.

Managers and employees are also required to obey all relative laws in practice, as well as all other rules and regulations in force in the legislative areas that belong to the company. The obligation to respect the law includes corporate compliance with laws, rules and regulations, and ethical standards related to trading on financial markets, as well as the use of information that is not for public use.

Part of the code of ethics for managers in finance makes trading in securities based on inside information. Each manager must make a personal contribution to promoting objectivity of information published in the financial statements and their compliance with relevant accounting rules. Responsibility of every manager is to perform regular assessments and work in accordance with the procedures in order



to ensure corporate compliance with relevant accounting regulations. Each manager is responsible to comply with the requirements and prohibitions established by the laws, rules and regulations, including those relating to accounting and auditing.

For non-compliance with applicable laws, policies, and directives of the group, it is necessary to establish sanctions in the form of civil or criminal liability. Disciplinary action can also be imposed as a milder form of sanctions. Application of regulation is more effective if the managers with their behavior serve as an example to show the importance of compliance. Honest and ethical conduct of managers should be in every aspect. Also, they must show willingness to support employees in all matters relating to ethics and willingness to report those who violate the rules set.

### **Protection of confidential and proprietary information**

Each manager is responsible for the completeness, correctness, and accuracy of information, presented to the public in a comprehensive and timely manner. Facts should not be forged, for example, deliberate inclusion of false statements in the disclosures, not correcting the false financial statements or records, providing false response or non-response to request control organs, signing a document with false information or allowing others to sign such a document.

### **Protection and proper use of assets**

Asset protection includes protection of tangible (physical) assets, intangible assets (software, devices, and technical documentation), financial assets, and protection of information. Entrusted assets must be kept with care and any loss or damage or risk that it could happen, should be reported. The property must be used only in the interest of work and with the end of work the right to use stops. However, with the cessation of work does not end the obligations regarding the use and disclosure of protected information.

### **Resolving conflicts of interest**

Conflicts of interest arise when personal interests are in conflict with the interests of the company. All decisions are made by companies in the interest of the company. Conflict of interest arises when the manager or employee undermines independent judgment that decisions are made in the best interests.

In this context, it is impermissible:

- Use a business opportunity, property, or information for the personal benefit,
- Have an engagement, outside the company, which can subtract time and attention, especially in companies that are competitors,
- Work in the boardroom or associations outside of the company where there is a conflict of interest,
- Make political contributions on behalf of the company, through funds or resources of the company,
- Give gifts, benefits, representation, and compensation to third parties, as well as receiving it from it, if it can affect the decision-making related to transactions with third parties.

Managers are personally liable for the business under the provisions of the code. For those who violate the provisions of the code, the sanction shall be imposed in accordance with the provisions of labor law, civil law, or the provisions of the internal regulations of the company. Depending on the size of the offense and the guilt, the sentence could be: oral or written warning, transfer to another job, compensation of damages by the offender, redundancy, in accordance with laws and internal rules.

### **Promotion and support of reporting unethical or illegal behavior**

Participants in financial markets, primarily financial institutions, should encourage the development of ethical awareness. In this sense, it is necessary to carry out the purposes of forming appropriate promotion codes and their implementation. Likewise, any attempt of unethical or illegal behavior in the financial markets must be recognized.

### **Respect for human rights in all financial operations**

Financial organizations should implement internationally recognized rights, through the value chain in the area of business. Special attention should be paid to the application of high ethical standards in the field of human resource recruitment in finance, as well as behavior in communications with the environment. Discrimination of any kind needs to be excluded. What should commitment to any financial organization is that in the chain of business partners they include the creditors and those users who have a code of conduct that respect and cherish the same values.

### **Fair, timely, and understandable disclosure of information**

Every financial organization should with its policies regulate the disclosure of financial information, within the rules of business of insiders, the listing rules of the stock exchange reporting, etc. The removal of information should be the responsibility of the authorized person. Information provided to the state and control authorities, and the public must meet the reporting criteria: accuracy, user-friendliness, and timeliness.

Financial ethics is determined by EU directives, laws and regulations of the state, local guidelines, directives, groups, and general acts of the company.

The code of financial ethics is an obligation and standard of employees, in the finance, which are required to implement it in their daily work, through mutual respect, tolerance, and teamwork.

## ***11.4.2 Implementation of Financial Code of Ethics***

Implementation of financial code of ethics requires the implementation of previous training to the employees on business finance. Training will include:

- Education of individuals loyal to the company capital,

- Education of employees,
- Physical appearance and spiritual behavior.

Rising of an employee loyal to company of capital implies such personality profile that will, by implementing policies and strategies of the company, execute the vision, mission, business, development, and operational goals and objectives and use optimum action tactics to solve specific problems.

Education of employees is made in a continuous acquisition of knowledge and innovation, appropriate job demands. In employment, young professionals who have the will to improve the new knowledge and gain experience in running and practice dialogue with customers must be prioritized.

Physical appearance and spiritual behavior are an essential prerequisite for the success of commercial transactions in the financial markets. The communications must be expressed creatively, willing and motivating speech politeness, without expressed hatred.

Task of a management of financial organizations is to take care about the socio-psychological and psycho-pathological state of employees for their work, to make them more effective in practice, especially in the financial markets, which do not suffer from errors. The major personnel problems faced by financial organizations are:

- Disagreement over the role of the governing structure, powers, and functions of individual members in a hierarchical structure.
- Deviations in the moral value system where people who on dishonest and unethical way acquired their property, disparage business associates and partners, of which they should live.
- Negative selection of personnel, due to the unrealistic defined mission, goals, and objectives of society, establishes poor organization of work and the way of communication between employees. Individual disability is concealed through teamwork and team (interdisciplinary) resolving of outstanding problems and issues based on science and international practice.
- Expressed hate speech is characterized by aggression, with no elements of cooperation, comity, and tolerance during the execution of joint plans or in dialogue within the organization and with business partners.

For employees, there is no acute awareness that their work is daily supervised by the competition, which uses all the resources in the design of the human psyche in order to realize personal goals. It changes the value orientation of the whole society, which requires a great deal of flexibility.

Attitudes and habits of individuals are difficult to change, especially in an environment where employees are fighting for basic survival. That's why they developed certain strategies of implementation of financial codes of ethics that apply depending on the achieved level of development ethics. The practice recommends the use of the following strategies:

- The strategy of sensitization,
- The strategy of concretization,

- The strategy of strengthening.

Sensitization strategy focuses on developing of a sense and needs of employees in the finance for ethical action. With the development of the ethics of the individual develops ethics of organization. Common stimulus for sensitization occurs in case of conflicts. Ethical standards, in this case, may require an active act or conscious omission.

Concretization is related to the taking of measures for the application of ethical values in financial practice. This process includes the following phases:

- Raising awareness of the values,
- Determining the value of the norms and standards of behavior,
- Identification of methods and means for the realization of value,
- Realization of value through concrete actions and behavior,
- Continuous review and modification of standards in accordance with the economic, human, social, and environmental criteria.

Fixing ethical behavior in financial operations is achieved in the following ways:

- Selection of employees with strong moral integrity,
- Education and training,
- Establishment of codes of ethics,
- Stimulation of system, reward, and punishment,
- Establishment of ethics committees, etc.

### ***11.4.3 Preventive Measures in Violation of Legal and Moral Norms in Finance***

The area of finance is a complex and specific system, which includes several subsystems which are interconnected and interwoven with direct feedback. Each subsystem is characterized by a range of economic, technical, social, and other characteristics. Developments in a particular subsystem, through mutual transactions, are transferred to the entire system, which could endanger its security and stability in the event of bad developments. Security in finance means the probability of execution of certain financial activities without negative consequences (financial and material damages) to the other participants in the transaction. In order to avoid negative consequences, it is necessary to take preventive measures. Preventive measures include measures of state and parasternal agencies and financial and other organizations focused on preventing negative social phenomena and to create the conditions so that the problems do not occur.

All those factors are the overall development of financial markets, and their security can be classified into three main groups, which are of heterogeneous structures:

- Participants,
- Institutions, and

– Financial instruments.

Thus, participants, institutions, and financial instruments are the main factors that determine the safety of the financial markets (and in finances), and consequently, the system of prevention (and repression) must be considered in their context, without ignoring the role of other who independently influence or specify.

There is a range of preventive measures. However, a significant role has financial education and training, personnel selection, control and regulation of financial markets, the media, the regulations in the fields of security and scientific-research work.

Financial Education

Financial education is an important subsystem of the overall system of preventive security in finance. People have participation in from early childhood to the end of life. In this regard, the education process should start from the age when they acquire the basic concepts about money and that takes into an old age. Holders of educational process should be the guardians, counselors, tutors, and lecturers.

From the acquired level of general culture, financial education and maturity to perform certain financial activity depends on the quality of financial development culture. Process of financial education in primary schools has no legal shaping. Young people acquire financial education only in secondary schools of the economic profession. Classes and extracurricular activities in secondary schools do not provide sufficient effects on the financial culture. The problem is more pronounced as there is no continuity of financial education, which should start at an early youth, which is in elementary schools.

Adults make up the largest category of participants in the financial markets. Their skills are different, and they can be roughly divided into those which are acquired through schooling of certain financial culture, which makes them adapt to certain situations and those who are not educated. The first group has built attitude and is ready to apply the rules. The second group consists of those who are not educated, so their knowledge of finance is formed under the influence of the environment, family, media, etc. Most members of this group have a high degree of competence to participate in the financial markets, but they often lack the knowledge necessary to overcome difficulties.

Financial education can be enhanced through the activities of educational institutions, companies that are engaged in the fields of finance, media, etc. Given the intensive development of financial markets, the current level of education calls for financial education in other schools and colleges that are not of economic profession. This would raise the ethical awareness of individuals and achieve maximum effects for inclusion in financial flows.

In order to enable staff to ethical judgment is necessary to:

- Engage in ethical causal relationships and methods for finding decision,
- Recognize problem areas and to understand them,
- Enable them to talk and judge when dealing with problems and making decisions.

### Staff selection

Dealing with finances becomes more complex job, especially with automation and globalization of financial markets. For doing business finance, personnel must possess certain psycho-physical abilities and character traits in order to be able to fulfill the requirements for finance tasks. Consequently, society has the need to train such personnel, both through regular schooling and later through the certification and licensing of new knowledge. Capacity of personnel changes over time, which requires continuous selection, according to the requirements of their work.

### Training of personnel

The main attention at the certification of knowledge, as the final part of the training, should be given to staff who manage and trade in financial instruments, which are the biggest source of danger. A good part of the problem in finance is the result of insufficient and poor quality of personnel training. Through the training of future personnel, they should develop the habits of reasonable behavior, and sense of responsibility, understanding that success in the financial markets depends not only on economic opportunity, quality and capacity of finance, types and quality of financial instruments, but also of the behavior of the participants, their cooperation, and solidarity which they can contribute. Fair and reasonable behavior during the training leaves lasting effects on his later behavior in finance. Education work should be substantially developed and adapted to the age.

Through training programs, it is necessary to train staff to avoid the mistakes of other participants, to predict dangerous behavior, and thus to avoid unwanted consequences. Training is expected to develop the habit of rational behavior, awareness of the dangers posed by the financial market, a sense of responsibility, self-criticism, resourcefulness and the ability to react quickly and appropriately, the perception that the regulations are not a function of his restraint, but a guarantee for better safety and other ethical qualities. All properties must be in the function of complex and modern requirements of a market, thus to secure market share.

In younger personnel, it is necessary to deepen the feeling of responsibility according to their tendency to exhibit risky and dangerous situations. They must be shown the moral, emotional, social, and financial consequences of bad decisions. In personnel should be developed characteristics of rational nature, such as attention, fairness, prudence, solidarity, etc.

The quality of education can be raised through the grouping of candidates according to qualifications. Acquiring knowledge depends mainly on the ability of teachers and their professional—pedagogical efforts. Nowadays, the lack of trained personnel in the field of knowledge transfer is marked. All this suggests that the training should be done as professionally as possible in order to achieve better results.

### Control and regulation of financial markets

Control and regulation of financial markets is performed for preventive supervision over observance of legislation in order to create a better and safer environment for all participants in the financial markets. Regardless of the habits, desires, and interests of

individual participants in the financial market, the duty of the control is to keep their behavior in terms that are normatively allowed. Control of the financial markets is done often in the course of transactions (money laundering) in order to minimize the negative consequences of its actions to the other participants. There is a preventive measure, and therefore, it carries a specially equipped and trained civil service.

Control of the financial markets is a difficult task because of the numerous restrictions and prohibitions to participants in the financial markets, as well as the high costs of performing. In order to achieve certain effects, holders of control must monitor the intensity and scope of financial markets and accordingly adjust the volume control. In addition, the control must be selective and contextually, temporally, and spatially directed to those phenomena that are sources of danger.

Its task is not only to detect danger but to prevent negative activities or to indicate the authorities for prevention. Control of the financial markets has a preventive role. Prevention is closely related with the ethics of the staff in the field of finance. With the development of the business community develops and knowledge that prevention is the most effective measure in preventing negative social phenomena (Francis 2000). The presence of control gives the impression to the participants in financial markets that are not left alone, but that, through legal and ethical norms, protect from nuisance that can be experienced in the financial markets.

Significant information, insights, and observations about the behavior of the participants in the financial market must be transparent. If there is active cooperation between the controllers and the media, then the future participants in the financial markets may be timely informed with useful information they needed to make decisions. So that the control, as a measure of social intervention, yielded certain results, it is necessary to coordinate the work of control organs and provide their connections to a unified system that will be able to work quickly and efficiently for every indication of a need, given that the financial transactions take place quickly. Effects of control techniques depend on its performance and the methodology of control actions. Control must not stagnate because its effects are greater if we increase investment in staff and technology. Above all, the control points to a very conscientious, responsible, and professional work.

Results of the controller should not follow through the number of measures that were taken, but the priority should be given to preventive action control, because better results are achieved by pointing out flaws or giving advice. Respectively in front of the controllers is imposed a serious task, especially when one needs to quickly decide on a measure that would achieve greater results.

### *The role of the media in prevention*

Mass media have a significant role in terms of educational and preventive action on the participants in the financial market. These funds are of great significance on improvement of the culture and financial stability of financial markets, especially if they provide the facilities of educational character.

Statistical data about embezzlements and frauds on the financial markets, with the presentation of the event, certainly influence the behavior of those who are familiar

with this information. Mass media can have a greater impact if they engage opinions of experts and actors in the financial markets with personal experiences.

### Regulations in the field of security

Legal regulation of financial instruments is an important factor for the security and stability of the financial system, and the control of their proper use is a preventive measure, which improves the safety of the participants. Regulations in the field of financial markets are important to the organization and implementation of prevention. They are, above all, prevention-oriented in its content because their goal is to establish a code of conduct that will create safe conditions for financial ongoing activities.

The basic regulations governing the operation of financial markets are of European, national, and local importance. In the fight against the negative effects on the financial markets, judicial and state authorities must be included. Preventive actions judiciary consists in providing the necessary information and suggestions for eliminating the causes, improvement of organization, and other solutions essential to prevent financial scandals. The judicial system can be relieved through the building of ethical and moral values. If there is erosion of ethical values, then it creates a fertile ground for the decay of money, financial crime, speculation and what ultimately causes the financial crisis. The state needs to be put into the protection of any form of illegal and immoral behavior on the financial market and not worry about the promotion of fairness and honesty in their work.

### Scientific Research

In the context of the general policy of maintaining security and stability in the financial market, an important place has scientific research. The results of research in the field of security of financial markets represent a reliable basis for the creation and implementation of financial policies. These results are important for detecting the causes of financial scandals and affairs, establishing measures to eliminate the causes and mitigation of their effects. Due to the lack of statistical data on the number of fraud and malfeasance, their scope is difficult to design a preventive measure and to determine the general focus of research.

For violations of financial regulations, legal and moral sanctions are provided. Legal sanctions are related to compulsory compensation for damages, civil and criminal liability, exclusion from membership, etc. The moral sanctions involve putting on a "black list," a boycott by the customer or by special interest groups, public advertising reprimand or punishment.

Range of sanctions is broad, especially if the way to achieve justice includes joint action of legal and moral norms. Each type of crime and pathological phenomena, such as business immorality, bribery, and corruption, must be recognized, and also, preventive measures must be taken with their reduction and ultimate elimination.



## 11.5 Ethics of the Society and the Individual as Obstacles to Investment

Prospective investors (investors in securities) including and savers and depositors are faced with numerous obstacles, constraints, and threats that are foiling to invest their free resources. That is why it is necessary to conduct a SWOT-analysis of the ethical values of the society and understand the causes of such deviations. Ethical values of contemporary society can be seen through its strengths/weaknesses and opportunities/threats as shown in Table 11.1.

Moral attitudes of individuals are mostly formed under the influence of the social environment. Consequently, ethics is characterized by the following individual strengths and weaknesses (Table 11.2).

**Table 11.1** Ethics in modern society

<i>Strengths/weaknesses</i>	
<ul style="list-style-type: none"> <li>– The individual is torn from the community</li> <li>– Acceptance of the concept of individual achievements</li> <li>– The only value system is the money</li> <li>– Acting in virtual space isolated from the normal rules of life</li> <li>– Loss of legitimacy, which the society understands hard and does not respect</li> <li>– Expressed manipulative consumer awareness</li> <li>– Indifference to everything that does not affect personal interest and standard of living</li> <li>– The source of earnings is daring speculation and farsighted surgery</li> <li>– Formal obedience of law is inconsistent with morality</li> </ul>	
<i>Opportunities/threats</i>	
<ul style="list-style-type: none"> <li>– Mass culture that imposes lifestyle</li> <li>– The erosion of moral dimension where greed and fear are basic starter activities</li> <li>– Revitalization and disregard of moral principles</li> <li>– Limitation of human freedom</li> <li>– The absence of a single ideology and world view which integrates the society</li> <li>– The effect of promoting on the formation of attitude toward life and standards of conduct</li> </ul>	

**Table 11.2** Ethics of an individual

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>– Self-esteem, safety, and social status</li> <li>– Reliance on morality, religion and conscience</li> <li>– Restraint and security in the purchase</li> <li>– The source of income is the work not the acquisition</li> <li>– Safety without mortgages and loans</li> <li>– Spending up to the amount of income</li> </ul>	<ul style="list-style-type: none"> <li>– Feelings of rejection and human humiliation</li> <li>– Fear of uncertainty affecting the mental instability of the people</li> <li>– The main purpose is to enjoy the material things</li> <li>– Putting logic of selfish personal interests above morals</li> <li>– Expressed emotions of greed—to obtain something before others get it</li> <li>– Expressed emotion of fear—mistrust, the possibility of loss</li> </ul>

Dominance of weaker moral values to real values decreases confidence of all participants in the financial market, especially the owners of the capital and money. Investors are generally burdened with negative attitudes and prejudice because their security role is not guaranteed in any way. In such conditions, the interest of investors can be attracted by high professional discipline and commitment of contemporary managers. Ethical virtues must be particularly pronounced in the financial intermediaries, where there is a need to promote and develop certain virtues that are specific to the service sector, such as:

- High moral and professional integrity,
- Tendency to winning the competition,
- Willingness and ability to understand, to help, and to serve clients on their path to satisfaction.
- The orientation of the major problems and expectations of the customer with the aim to deliver satisfaction.
- Honest and enjoyable relationship with their clients, which are not false and burdened with emotional lines.

Selling is a complex process that requires constant communication with the client. In this sense, positive experiences in the market economy suggest the need to create sales and project groups that will replace the individual. These groups tend to become basic units in sales. The teamwork of each member of the team is to investigate and deal with one or more factors, and their synergy is achieved through creative sales solution.

### ***11.5.1 Financial Ethics in Order to Protect Investors***

To ensure the smooth functioning of financial markets, it is necessary to provide adequate protection to investors or owners of capital. The importance of their protection stems from the role they play in the capital markets. Therefore, the investor must be protected from all parties that may, in the role of the debtor, trick or misused his interest. Legal framework for the protection of investors in the single market is based on the provisions of the following documents:

- Directive on compensation 97/9EZ investors,
- A prospective directive,<sup>2</sup>
- Directive of transparency,<sup>3</sup>

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<sup>2</sup>European Parliament and Council Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending, Directive 2001/34/EC, OJ L 345/64/03.

<sup>3</sup>European Parliament and Council Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending.

- Directive on market abuse,<sup>4</sup> and
- MI Fid's<sup>5</sup>.

In addition, to protect the interests of investors (depositors) in the banking and financial market, it is necessary to ensure the financial codes of ethics. The investor has to have a sense of security and confidence in the ethical values of the financial market and the state. Investor interest is protected against:

- Debtors (which may misused investors' interests),
- Intermediaries in financial markets (primarily dealers and brokers), and
- The risk of repossession and collection of revenue from its usage (coming from the issuers of securities, broker-dealer companies and institutions in the financial markets).

To maintain the trust, it is necessary to protect each individual investor in relationships with other participants in the financial market.

The basic instruments of investor protection are:

- Transparency of financial reports and other information related to the presentation of the real,
- Transparency of financial operations that are relevant to investors' decisions (price, courses, indexes, etc.),
- Transparency of information and decisions of the competent authorities of significant price movements, exchange rates, indexes or affect the fluctuations in the market,
- Protecting savings and deposits from banking abuse (banks should not invest in risky activities without approval savers and depositors),
- Protection of banking abuse (obligation of bail by the banking broker or dealer before undertaking transactions in the financial market),
- Protection against the risk of receivables (the investor must be compensated, costs and loosed profits).

Creation of such instruments would create a market environment in which the investor bears the consequences of bad decisions. Misuse of ethics and ethical principles give rise to financial fraud and robbery. Large scams are often related to new financial products, whose schemes are based on the documentation that is designed for specific guidance on irregular activities. Moreover, organized crime is working in support of the financial institutions for bribery, corruption, pressure, etc. Countries that are involved in the market economy have the key task of the ongoing fight against the abuse of ethics and ethical values in banking and the financial markets. For this purpose, in addition to compliance with legal regulations, it is necessary to make continuous education on ethics and ethical principles, standardization of financial products, and codification of ethics.

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<sup>4</sup>European Parliament and Council Directive 2003/6/EC on insider dealing and market manipulation (market manipulation), OJ L 96/16/03.

<sup>5</sup>The Markets in Financial Instruments Directive 2004/39/EC.

With the growth and development of the financial market and its implications for the economy, and the increased number of deceit and manipulation (Eric 2003) increases the need for stricter regulation. Consequently, it is forbidden to carry out actions that lead to the abuse of the financial markets and above all to the detriment of investors. The illegal actions include:

- Trading based on insider information and
- Manipulation on the market.

### 11.5.1.1 Ethics in Trading Based on Inside Information

Insider trading on the basis of (privileged) information for investors may be a bad business decision. Thanks to the computerization information is rapidly expanding, especially in the business world, which creates an opportunity for unjustified enrichment. Despite the fact that the expansion of insider information is strictly prohibited, there are rare cases of punishing investors, brokerage firms, or companies.

Inside information according to Article 1 (1) of the Directive of market union abuse is defined as “information of a precise nature which has not been made public, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which if it were publicly available, probably had a significant impact on the prices of those financial instruments.”<sup>6</sup>

The insider information can be classified, and the society suffers the consequences on the basis of certain events, circumstances, or information relating to the company. Such information relates to the following facts and/or circumstances:

- Data and statistics of public institutions,
- Expected publication of agencies, related for the value of financial instruments,
- Decisions on the amount of bank interest rates,
- Decisions by government and other public bodies on taxes, debt management policy, etc.
- Decisions relating to the structure and governance rules for stock indexes, etc.
- Decisions related to the trading rules of the regulated and free markets,
- Relevant orders of public organizations.

The problem occurs when a reasonable investor tenors such information as part of the basis for making investment decisions. Preventing market abuse of privileged information is based on the provisions of the trade inside information. Purchases of securities on the basis of confidential information on the company, the so-called inside trading on developed markets is punishable and in emerging markets serves as the foundation for a good profit. Inside trading is buying and selling of securities on the stock exchange on the basis of information concerning the company known by the narrow circle of people. The holders of such information are mostly people from top companies. They are forbidden to disseminate such information so they allow

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<sup>6</sup>European Parliament and Council Directive 2003/6/EC on insider dealing and market manipulation (market manipulation), OJ L 96/16/03.

others or themselves (through their own trading) to earn more than others (Vunjak and Kovačević 2009).

What is important for investors is that, with a change of owners, confidential information often turns into misinformation. Investors should hold publicly available data published on the stock exchange so that they would not be damaged by a second hand.

No market is immune to the enrichment of the abuses. Developed financial markets are well known for continuous fight against fraud. The role of stock exchanges, among other things, is that it constantly monitors the behavior of investors and their brokers, especially when it is pronounced volatility of securities. To prevent the loss or improper earnings, supervisory bodies need to come to confidential information. Accurate and timely information can be obtained through confidential sources. If you are trading based on confidential information, then the profit on the stock market is obtained by few of those who possess such information.

Trading of confidential information is given when the company, whose shares are circulating on the daily stock market, do not innovate stock exchange prospectus, and do not disclose the latest financial statements. In the prospectus must be published data that reflect the actual financial condition of the company, which allows investors to carry out an objective assessment of the company. The company usually disposes the publication of recent financial statements for two reasons: negligence or intent to conceal poor or excellent financial indicators. In the case of poor business performance is disposed innovation prospectus in order to put off the moment of publication of the height loss. Good results are hidden to prevent the arrival of new investors.

If the same rules of publication would be valid for all participants, then buyers and sellers could be serene. Due to the considerable risks, investors do not want to invest heavily in certain companies if they do not have some discretionary data. Great stakes force them to deal with illegal activities or to recruit insiders in order to obtain a reliable basis for concluding contracts. Large price fluctuations on the stock market may be partly indicative of irregularities. Trading on the basis of insider information can be difficult to prove. If there is evidence that someone is offended by the competent authority punishment shall imposed. If the evidence is not clear, but there is only circumstantial evidence, the case focuses on the court.

In trading on the basis of insider information, it is difficult to distinguish whether it is just about trading or fraud or extortion. For example, if the CEO of the company through "their people" spread information about the takeover of the company, in which all workers will lose their jobs and then propose a joint workers to invest their actions in a newly established company that will buy a "verified buyer," then it comes not only to trading based on insider information, but also to fraud and extortion.

In small markets, where investors are relatively narrow circle, insider information is hard to hide, so that they lose their meaning because they are open to everyone. Insider information can be used, but not for the purpose of making a profit or minimize losses, along with a notice of the supervisory authorities.

A case of the late notification of important company event is also considered a misuse of insider information. For example, if information on dividends comes late, then in the meantime, people from the administration can buy actions.

Financial code of ethics should identify the persons who are considered insiders, as well as the duties and responsibilities in dealing with insider information. Potential insiders are all persons who have access to insider information as well as persons who possess this information, and they know or should know that the information is of an insider character.

Potential insiders, the primary significance, may be managers or executives of companies and supervisory board members as well as their related entities. In the people associated with the persons who perform the duty manager are spouses, serving, persons who live with him in the community, people who the manager manages, i.e., the ones who he directly or indirectly controls, which is established for their own benefit or a person who has an economic interest significantly similar to the interests of the manager. Secondary insiders are to be found in the ranks of employees, auditors, attorneys, brokers, investment advisors, tax advisors, property appraisers, judges, mediators, arbitrators, etc., in possession of confidential information that can be determined by persons who are in direct or indirect contact with the insiders like the person working on government job (commission for the prevention of monopoly, etc.), persons involved in the takeover, market makers, etc.

Trading on the basis of inside information must be controlled because it is contrary to the principles of loyalty, professionalism, and fairness. Additionally, trading cannot be left to the liberal market mechanisms and business skill. Financial market, more than ever, requires strict regulation and supervision to prevent crises and stock market meltdowns.

Person who has insider information is prohibited:

- Use insider information for own account or for the account of a third party,
- To disclose the information to any other person, except making the information accessible in the normal course of performing work or duties,
- Convince other people to gain benefits on the basis of this information,
- Publish inside information.

The society may give notice to the public of all the inside information and their changes relating to society. Manner of publication shall not mislead the public. The company may postpone public disclosure of insider information in the event that:

- Announcement undermines the interests of society,
- Disposal does not mislead the public,
- Can guarantee confidentiality of this information.

Because of easier control of insider information, it is necessary to prepare a list of insiders. Insiders must be familiar with their obligations and are entitled to any sanctions in case of disclosure of confidential information.

### 11.5.1.2 Market Manipulation

History knows many stock market manipulations that deliberately affect the trade with the aim of making profits by market conditions. Modern stock exchanges prohibit the transaction, whether investors or brokers, which may affect the supply, demand, or price of financial instruments, as well as the making of untrue picture of the organized financial market. Consequently, it is forbidden:

- To influence the market price of securities or other financial instruments,
- To influence the final decision of the client through various forms of manipulation,
- Influence the creation of the illusion of the transport volume of securities and other financial instruments,
- Form a fund, through which it can influence the formation of unrealistic market price of securities,
- Execute transactions in securities which do not change the owner,
- Induce other persons to purchase or sell securities, etc.

#### *Violation of ethical standards through pricing securities*

- Manipulation through the planned impact on trade in order to make profits, which is not in accordance with market conditions, is most commonly done through fictitious trade contrary to orders, rumors, or corners.
- Fictitious sales occurs when the owner and the buyer reach an agreement to carry out simulated buying and selling at a price above the prevailing market without a change of ownership of the financial instrument that is the subject of sale. This type of manipulation creates the illusion of an artificial increase in the price of paper and then persuades an investor into buying at a higher price.

Opposite orders also correct the price of securities through artificial semblance of trade, so that the user provides simultaneous orders to buy and sell the same stock.

Mass psychology, daily events, news, rumors, etc., effect on the price of securities in the short term.

Psychology of the mass has a major impact on the movement of supply and demand, in other words price action. Investors often behave according to the psychology of mass, i.e., buying more when prices rise, thus raising the price action even more, and that attracts other investors. Such a chain reaction aims at earnings. When growth is interrupted, great panic is caused among investors and everyone wants to get rid of shares, bringing down prices, also indefinitely. Investors behave like a herd, chasing each other, causing huge losses. Experienced investors avoid mass psychology and behave rationally without emotions (fear and greed). Small investors are the most exposed to the influence of emotions because, in order to protect their own, laboriously acquired the minimum stake they collect numerous tips so that the inexperience and panic often become subject to manipulation.

Wrong decisions can be made under fear psychosis. For example, fear of war forces investors to cash in their securities. In such conditions, on the stock market there are buyers and sellers of securities. Buyers of securities are optimists who believe when the war will come; it will last for a short time, etc. However, when

it comes to war, inflation is inevitable. So that the money would not be devalued, depositors want at any cost to replace the money for some other values as soon as possible. Given that the property is not to be reached in a short period, investments are mainly centered in securities.

Investors who have no practical experience often make their decisions based on unverified information and opinions of others, especially the psychology of the masses.

Artificial forming of price of actions can be performed through a corner. Corner is the formation of a monopoly situation in which investors have the option to buy a particular paper weight only from a monopoly holder at a higher price.

In the current conditions, manipulations are skillfully conducted via the Internet as it is difficult to verify the information on companies offering their financial instruments. In addition, companies can disclose a lot of false information which investors use to make decisions.

Developed countries have through legislation and effective functioning of institutions for the regulation of financial markets set the framework of behavior related to the price establishment. However, collusion on pricing however can occur as a specific ethical issue. In addition, discrimination of clients in terms of price is expressed. In banking, for example, the common feature is that the cost of services for small depositors is higher than prices for business customers. These things point out the need for establishment of ethical framework in policy pricing. Clients quickly recognize and condemn the unethical price policy. Unethical behavior can result in the short-term success, but it cannot be the basis for long-term earnings. Where the money is, there is also desire to make the acquisition, which leads to individual misconduct. Unethical behavior is more pronounced if there are not any set allowed limits for price action. The sooner we realize the importance of ethics in determining the price, the easier it will be to solve the problems of greed which is reflected in the setting of unrealistic prices.

### *Violation of ethical standards through the manipulation of clients*

In a market economy, which is a competitive event, companies use any means to win a critical mass of customers needed to achieve the targeted profit. In this case, the manipulation becomes a way of life that often goes below human dignity or more precisely under the ethical and moral standards on civilized society.

Stimulation of users of products/services in finance assumes respecting the client's needs, wishes, preferences, and motivations in the process of deciding on a purchase. Scientific methods provide answers about what the individual was and what is now. However, there is no such response if you want to know what client may be or what will be. It is difficult to define a man through time and space distance and his attitude toward things, so with the products he cannot be defined until the end. Employees in the sales of financial products/services should recognize the client's problem manifested by product in the process of stimulation. Seller should not manipulate the client. Client who is manipulated loses freedom as an essential determinant of its existence. Manipulation means the seller's monologue in which clients do not



sufficiently understand the above, but in the opinion of the seller assumes himself to agree.

Manipulator seeks to specify clients to act as best suits his interest. That is, he does not allow customers' choice and with that he is stifling creativity and power. Manipulation is expressed where there is no true human dialogue with clients and genuine communication. Through dialogue and communication with the client, he can understand the position presented, but that does not mean that they were to agree. Through interaction with the seller, client has the opportunity to develop a creative solution to their problem.

On the way to democratization society enters the spiritual situation in which people become psychologically depressed. People are increasingly looking for information and media in which they could believe. Also, people desire communication and dialogue that will cause a lot of injustice. People are deceived in most cases; many of them completely lost hope. Such people with fear think and decide. If you choose wrongly, then they their errors justify with the situation and circumstances rather than admitting that they did not want to do it differently. So, people prefer to opt for the so-called situational morality, instead of a permanent system of social values. In such circumstances, people are left without moral standards. If there is no moral ideal, it is difficult to distinguish what is moral and what is immoral. Moral standards should be the most rational and humane real possibility.

Today, moral codes give way to new social realities. Modern manipulators in practice bring more immoral because it prevents people to act according to their conscience—the adopted standard of what is moral and immoral, just and unjust, good and evil, etc.

In communication with clients, it is necessary to spread the truth. Truth as a moral rule must be imposed to minimize subjectivity by the seller on behalf of the company it represents. Seller should not induce the client to rationalize their goals and interests and to accept the offered products/services as the only truth. Seller must respect the interests, goals, needs, desires, attitudes, and preferences of customers, at the same time defending its vision, mission, and goals of existence.

Therefore, customers should be stimulated and allowed to define more precisely what their interests, goals, and visions and to purchase them to be the basis for the creation of new products/services.

Seller, as man-humanist, must be a responsible person and somehow educator of a client to open himself up about his problem and to talk openly. In performing its functions, the seller must make an effort to gain and consolidate the trust of his client and at the same time preserve the dignity and honor of the profession. In his speeches and actions, he must respect the requirements of professional ethics, culture, and good business practices that are contrary to his conscience. Seller shall not acquire the infamous clients or unauthorized manner, such as by giving unrealistic estimates and promises of success, encouragement or repudiation of corruption, involvement in corruption, recapture of customers from others, etc.

### **Violation of ethical standards by investment advisers**

On the financial market is perceived a role of investment advisers. Their role is to provide “expert opinion (advice) to clients on how their investment operations, on exactly certain issues in order to enable or facilitate the adoption of their own decisions on the disposal of securities (that is on their purchases or sales)” (Grubišić 2008).

Business of investment advisor requires great responsibility to the profession as well as clients represented. Its role is to:

- Accurately and fairly reporting (more informally friendly than professionally),
- Providing specific advice on profitability and riskiness of certain securities as well as the sales process,
- Construction of a correct relationship with investors,
- Introduction to the state of the client,
- Placing the client’s interests ahead of their own,
- Getting to know the client’s own interests,
- Behavior in accordance with the principles of good professionalism (without intent, carelessness, and negligence),
- Responsibility for the improper execution of duties,
- Responsibility for the illicit aspects of behavior (fraud, conduct transactions without the consent of the client and similar dishonorable actions).

Procedures for investment advisers must comply with the financial ethics. Financial ethics does not accept the following procedures:

- False statements and wrong listing of client,
- Insufficient information,
- Advice based on rumors and inside information,
- Disregard for privacy.

Manifestation of unethical practices of investment advisers in practice is different, and it can be seen in Table 11.3.

Any decision of investment advisers must meet three basic ethical principles:

- That is lawful,
- That it creates a balance of interests, and
- That the participants feel good about the decision.

At the same time, each transaction according to the financial regulations and ethics should be approved by the client. Respectably telephone reservation should be avoided or to leave blank orders that can be misused.

Code of ethics of investment advisor must include provisions relating to:

- Professionalism,
- Honest and loyal relationship,
- To preserve the dignity and integrity of others,
- To preserve the reputation of the profession,
- By telling the truth to customers and the public,

- Protection of confidential information,
- Taking into account the conflict of interest between clients, and
- Bringing their client interest in this work.

Investment adviser cannot make decisions on behalf of the client but only to provide expert assistance. With professional assistance, investment adviser must disclose potential conflicts of interest that may arise from the advice provided to the client.

**Table 11.3** Manifestation of unethical practices of investment advisers in practice

Unacceptable procedures in financial ethics procedures in the event of unethical practices	– Manifestation of unethical actions in practice
False statements and wrong listing of clients	<ul style="list-style-type: none"> <li>– False views of the market price of securities</li> <li>– False statements on issuers</li> <li>– False representation commissions and transaction costs</li> <li>– Bringing untested assertions</li> <li>– Promises to the client without the intention to fulfill</li> <li>– Incorrect display of opportunities and fact (by aggrandizement or minimization)</li> <li>– Inadequate disclosure of transactional risk</li> <li>– Advice unconformity to a particular client</li> <li>– Not determinate the financial situation, goals, and needs of the client</li> </ul>
Insufficient Information	<ul style="list-style-type: none"> <li>– Selection of information for a client with a purpose</li> <li>– Failure to comply with customer complaints</li> <li>– Omission from the list by certain statements relevant to a decision of the client</li> </ul>
Advice based on rumors and inside information	<ul style="list-style-type: none"> <li>– Conveying inside information</li> <li>– Basing an advice for a client on inside information and rumors</li> <li>– Omission to the stock market about inside information</li> <li>– Deliberate coarsening of transactions for correcting more important price of securities on the market</li> </ul>
Disrespect of privacy	<ul style="list-style-type: none"> <li>– Tactless approximation to the client</li> <li>– Unprotected confidential client information provided to other parties (statistics, agency, etc.)</li> </ul>

## 11.6 Discussion

### 11.6.1 *Possible Provisions of an Ethical Code of Brokerage Firms*

Stock brokers (brokers and dealers) have full freedom, within the legal framework and in the extent of permitted authority to conduct financial transactions. Often business challenges arise for which solution legal standards cannot be applied, but need a moral decision. Given that morality is an internal affair of each individual, then a moral judgment would not be fair. The behavior of stock brokers can be directed in the desired direction by prescribing codes of desirable behavior. This would facilitate the work and to employees and to managers. The behavior of stock brokers must be under constant supervision. Also, it is necessary to establish a system of authorization for certain jobs, especially higher value tasks at non-market prices and trading outside of time and place.

Accordingly, the code of ethics should include the following provisions:

- Code of Ethics or code of financial moral on the stock market is a unique act that applies to a single territory and honor before all courts under their jurisdiction,
- In dealing with other stock brokers, they are required to carry out tasks professionally, according to business ethics that requires professional rules and understanding of the environment and that behavior does not undermine the reputation of business brokerage firms,
- Business ethics implies respect for the principle of good faith, honesty, and fairness as well as acting in good faith and in accordance with good business practices in the financial relations with the other party,
- The financial markets are does not allow manipulation of brokerage firms or that brokerage firms tamper others with the goal of artificial pricing,
- Intermediary organizations shall not disclose false information about the products that are the subject of trade or any other information that may deceive the other side,
- It is forbidden to engage in any activity that is inconsistent with the business and reputation of intermediary organizations,
- The stock exchange brokers cannot perform additional work within the scope of their work and profession nor be tied to the performance of these activities. For any additional job, brokerage firm must obtain the written consent of the competent person,
- It is forbidden to accept gifts, other than those that are meant for promotional purposes,
- Professional associations must report any observed violations of ethical rules,
- The stock exchange brokers should not encourage or spread rumors that may affect market conditions, location, reputation, and competitive advantage in the financial market participants,

- Announcements intended to public may be made only by authorized persons. Others are obliged to communicate to the usual standards,
- Recommendations of brokerage firms must be substantiated in other words besides quoting information that is based, and recommendation must point out the advantages and disadvantages, as well as possible risks,
- The stock exchange intermediaries may not impose on transactions related to the unequal position of partners, using the difficult economic situation, threats, deception, or deceiving,
- Sanctions for violation of moral code are primarily of moral–social character,
- Terms of the contract that are not proportional to the risk taken out of contracts are contrary to business ethics,
- All the information about the business purpose must be kept secret, especially if the job could affect the price of financial instruments,
- Financial intermediaries should not unconscionable force financial products of their employer in the financial market,
- Financial intermediaries should not be allowed to have a share in the profits by jobs performed for their bosses,
- Trading of employees for their own account must be provided,
- Financial intermediates should not use insider information or harm customers and company,
- Restrictions regarding betting on the result,
- Ban the use of opiates,
- Protection against fraud and money laundering,
- A clear and precise tariff and commissions,
- Unambiguous terminology.

### ***11.6.2 Possible Ethical Solutions in the Field of Trade in Financial Instruments***

For a successful trading of financial instruments is necessary to develop awareness among the participants on the need for a conscientious, fair, and equitable action on the financial market. Such action may be directed to market methods and legal regulation. If you establish disciplines in financial market, then this is the way to its stability, the strengthening of the national currency, and the development of a healthy economy. Therefore, anarchic appearance on the market should be controlled. Particularly, pronounced control measures must be at critical points, such as:

- Monopoly of participants,
- Unfair competition, and
- Gray financial trade.

Monopolistic position of the participants should be broken through mitigation criteria for access to financial instruments, in order to provide conditions for healthy

competition. This would restore lost confidence in institutions and at the same time provide the opportunity for small investors (Radovic 2008).

Fight with unfair competition is the main area of trade policy of the financial markets. An example of unfair competition is expressed in developing markets. We can encounter unfair competition in the bank, for example, which offers loans to the value of the contractual obligations in local currency is calculated based on the Swiss franc price (indexed) and in addition it is known that the Swiss franc will raise. This bank has entered into a transaction and activity that is unfair competition in the financial market. Although it is legally permissible transactions, based on the foreign currency clause, the contract may be considered void because there are indications of “Gombeen man” contract. In other words, the bank is using the state of emergency or material difficulties of the others, their lack of experience or lightheadedness to secure a benefit that is evidently disproportionate to what the client has given.

Each country, especially those in the developing world, should be worrisome by the trade of equity that does not have positive developmental effects on the economic system. This trade makes the rich overnight, without any work. Inflation from the financial markets, without creating new value, does not guarantee the sustainability of the economy. “Nowadays the preeminent paradigm that financial markets seek equilibrium is false and misleading, so it is possible that our present troubles are largely caused by the fact that the international financial system has been developed in this paradigm” (Soros 2008).

The turmoil of the financial markets, due to the growth of risk, has led to the destabilization of the financial sector. Decline in stock prices, indecision in investment and borrowing, the uncertainty in the preservation of the real value of assets, disorientation of investors’ mistrust of financial institutions, and rising interest rates further encourage speculative activity in financial markets. In a system where capital is more expensive and the goods are more and more cheap, gray economy is particularly evident. For the survival of the gray financial trade, a corrupt government is required, so that gray financial markets are the biggest financier of corrupt elites, why they take bribes. Operating in the gray economy, together with legal “increased business indiscipline, threaten legal order of the country, allowing spontaneous constitute a parallel system in several spheres of social life” (Thomas 2010).

If these critical points cannot be controlled, it will lead to instability of market prices. Official market price should represent the interest of the greatest number of participants and market majority. Otherwise, the market price cannot be a raper of official market price of objective character, by which it would make comparison of calculative value. Financial rapper, during its duration, mode of action, and the applicable standards are set by stock exchange rules and codes of financial ethics. Tariffs in trade–financial transactions must be based on market principles. Person who does the tariff must include the cost of stock market operations, reported on a neto basis. The Stock Exchange of tariffs must be transparent to clients and others.

Despite great efforts to resolve moral dilemmas in the field of financial instruments by the help of financial code of ethics, the use of penal policy is unavoidable. Penal policy in trading of financial instruments relates to security measures, offenses, and crimes. Offenses arising due to:

- Unauthorized use and disclosure of confidential information,
- Dissemination of false information,
- Manipulation of prices,
- Quoting false information in the prospectus or the public invitation,
- Unauthorized listing or trading of securities,
- Publication of false balance, and
- Misuse of estimates.

Financial markets are faced with new ethical challenges—an explosion aided by new information technologies. Unauthorized access to information and data theft are a great moral challenge. Fundamental values—truth, honesty, fairness, respect for others, which are used in moral judgment of certain ethical problems—are now marginalized, for the sake of maximizing the commercial opportunities. Such tendencies of new technologies must be subordinated to some form of regulation. Determinant of the regulation should be the ethical behavior of the participants of virtual market.

### ***11.6.3 Desirable Ethical Principles in Financial Trading with Stakeholders***

Application of the code of financial ethics applies not only to employees, but to all stakeholders.

Table 11.4 shows the area of application of the code of financial ethics and basic ethical principles in financial trading with certain groups:

It is the duty of employees in finance and in the emerging market to carry out its obligations conscientiously, with the best business practices, within its capabilities and in the best interest of the company. Decisions must be based on the opinions and information provided by experts, who are conscientious and competent in the field of finance. If a person is acting in accordance with the stated care, they are not responsible for damage caused in the society on the basis of such decisions. For example, if a banker finds risky business he shall not be liable for damages if they have acted with appropriate diligence (complied with procedures contract).

Persons who have a duty to the company (board members, managers, etc.) cannot guarantee the achievement of certain operating results, but only within the limits of personal engagement opportunities with “due diligence”. Standards that should strive people who have the duty are abstract and expressed words such as “good financier,” “reasonable man,” and “a good expert”. Therefore, persons who have a duty to finance operations must behave like good financiers, with good professional care and in accordance with the professional practices and ethical standards. Action must be in the best interests of society and not in their personal interest.

**Table 11.4** Eligible ethical principles in financial trading with stakeholders

Scope of application	Preferred ethical principles
Relations with shareholders	<ul style="list-style-type: none"> <li>– To increase the value of investments</li> <li>– The need to protect small shareholders, which are cornerstones of banking and capital markets</li> </ul>
Relationship with employees	<ul style="list-style-type: none"> <li>– Encouraging employees to shareholding</li> </ul>
Relationships with issuers	<ul style="list-style-type: none"> <li>– Investment policy should rely on principles of ethics, safety, and reliability</li> </ul>
Relationship to the administration	<ul style="list-style-type: none"> <li>– Download process should not inhibit or accelerate</li> <li>– Act in the interests of all shareholders</li> <li>– Timely and indiscriminate information</li> <li>– It is not allowed to abuse inside information</li> <li>– Personal interest should not be expressed</li> </ul>
Customer relationships	<ul style="list-style-type: none"> <li>– Respect for the client</li> <li>– Relationships and communications with customers are based on the principles of safety, integrity, professionalism, and transparency</li> <li>– The goal is to maximum customer satisfaction</li> <li>– The price includes the risk factors related to the individual client</li> <li>– Continuous monitoring of customer satisfaction</li> </ul>
Relationships with contractors	<ul style="list-style-type: none"> <li>– Construction and development of a network of permanent and mutually satisfying relationships</li> <li>– Relations based on the principle of accuracy, impartiality, and transparency</li> <li>– Application based on objective criteria of competitiveness and quality of financial products/services</li> <li>– Respect ethical criteria</li> </ul>
Relationship with external bodies and state authorities	<p><i>State and authorities</i></p> <ul style="list-style-type: none"> <li>– Relations based on the principle of transparency, correctness and not to hinder cooperation with respect</li> <li>– Avoidance of collusion that goes against these principles</li> </ul> <p><i>Media</i></p> <ul style="list-style-type: none"> <li>– Respect for the role of the media in informing the public, particularly investors</li> <li>– Quickly and transparently respond to the needs of the media with the protection of business secrets</li> </ul> <p><i>Political parties, unions, and associations</i></p> <ul style="list-style-type: none"> <li>– Restraint from the event or initiative prevailing of political nature</li> <li>– Abstention from political pressure on their representatives</li> <li>– Restraint of trade unions or associations of proposals that could lead to a conflict of interests</li> </ul> <p><i>Advertising</i></p> <ul style="list-style-type: none"> <li>– Advertising in accordance with the basic ethical values of society</li> <li>– The content of the message must be truthful, not insulting or have harsh message</li> <li>– Reporting to the public must be fully, effectively, and in line with market expectations</li> </ul>



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# Chapter 12

## Business Ethics and Chinese Overseas Investment



Jing Bian and Frank Marchione

### 12.1 Introduction

The world has seen the development and expansion of Chinese business. Since 1978, from the Open Door policy to the Walking Out strategy, China has shown the rest of the world a growing nation. Today, China is actively involved in overseas investments. However, there are some controversies around the Chinese overseas investments. Among others, business ethics is an issue being discussed frequently. As a relatively new concept to Chinese enterprises, has the notion of “business ethics” been widely accepted and adopted by the Chinese business circle? Is there any law or regulation to regulate and enforce this concept? If so, how to evaluate the ethical performance of these investments and the efficiency of the relevant legal regime?

This paper, by examining the regime which promotes, enhances, and regulates ethical business and conduct, aims to answer the above questions. In this paper, the first part reviews the development and its background. Secondly, this paper looks at the legal and institutional framework for overseas investments and the functions of the key regulatory authorities. Following these, a close study on the current law, regulation, and industrial guidelines relating to ethical requirements will be carried out. Last but not least, a conclusion will be drawn based on this research.

### 12.2 The Development of Chinese Outward Investment

China has experienced great changes in the last three decades. Despite the world seeing China as a venue of foreign direct investment initially, the total overseas

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investment made by China, in fact, keeps a rising pace. Currently, there is no unified definition for overseas investment, and in some occasions, the terms overseas investment and outward investment are often interchangeable. However, due to the foreign exchange control policy, there is a definition given to “overseas direct investment”. According to the Provisions on the Foreign Exchange Administration of the Overseas Direct Investment of Domestic Institutions, “overseas direct investment” refers to a domestic institution’s overseas formation of an enterprise or project or overseas acquisition of the ownership of the controlling stake in or the business management right to an existing enterprise through formation (by exclusive investment, joint investment, or cooperation), merger, acquisition, or purchase of shares, upon the approval of the competent administrative department of overseas direct investment.<sup>1</sup>

China’s outbound investment has gained rapid growth. In 2010, the Chinese outbound direct investment (OFDI) net flows reached US\$ 68.81 billion, which increased by 21.7% from 2009.<sup>2</sup> Moreover, by the end of 2010, there were more than 13,000 domestic investing entities which had set up around 16,000 overseas enterprises, in 178 countries (regions) globally.<sup>3</sup> For the year 2012, Chinese OFDI was \$77.2 billion, up from \$60.1 billion in 2011.<sup>4</sup> Furthermore, domestic Chinese investors invested in 4425 overseas enterprises in 141 countries and areas in 2012.<sup>5</sup> The recent figure has further illustrated this growth. In 2015, China’s nonfinancial outbound direct investment reached \$118.02 billion and realized a growth over 13 consecutive years with an annual growth rate of 33.6%.<sup>6</sup> Overall, during the Twelfth Five-Year Plan, China’s outbound direct investment was 2.3 times that of the Eleventh Five-Year Plan.<sup>7</sup>

Furthermore, Chinese companies’ outbound investment is expanding from all dimensions; in particular, private enterprises are more active than before. In July 2012, the Wanda Group announced that its acquisition of US cinema chain AMC had been approved by all relevant authorities in China and the USA.<sup>8</sup> This purchase, completed by China’s private enterprise, made the Wanda Group the world’s largest

<sup>1</sup>State Administration of Foreign Exchange, Issued date: 13 July 2009, effective date: 1 August 2009, Article 2.

<sup>2</sup>Ministry of Commerce, National Bureau of Statistics, State Administration of Foreign Exchange (2011), Statistical Bulletin of China’s Outward Foreign Direct Investment 2010.

<sup>3</sup>Ibid.

<sup>4</sup>Reuters (17 Jan 2013), “China’s Outbound Investment Leaps to Record High in December”, <http://www.cnbc.com/id/100389317>, last accessed: 1 July 2013.

<sup>5</sup>Ministry of Commerce (18 January 2013), “The Bulletin of Chinese Non-financial Outward Foreign Direct Investment in 2012 (2012 Nian Woguo Feijinronglei Duiwai Zhijie Touzi Jianming Tongji)”, <http://www.MOFCOM.gov.cn/article/tongjiziliao/dgz/201301/20130100006028.shtml>, last accessed: 1 July 2013.

<sup>6</sup>Ministry of Commerce (18 January 2016), “Official of the Department of Outward Investment and Economic Cooperation of the Ministry of Commerce Comments on China’s Outward Investment and Economic Cooperation in 2015”, <http://english.MOFCOM.gov.cn/article/newsrelease/policyreleasing/201602/20160201251488.shtml>, last accessed: 16 September 2015.

<sup>7</sup>Ibid.

<sup>8</sup>Wanda Website (26 July 2012), “Wanda’s AMC Purchase Approved”, [http://www.wanda-group.com/2012/latestnews\\_0726/144.html](http://www.wanda-group.com/2012/latestnews_0726/144.html), last accessed: 11 October 2013.

**Table 12.1** Chinese companies buying in Europe 2012

Deal	Value (\$m)	Target area
Bright Food's acquisition of Weetabix	1938	UK
Sinopec's acquisition of Talisman Energy (UK)	1500	UK
Weichai Power's acquisition of Kion Group	928	Germany
CiC's acquisition of minority stake in Thames Water	780	UK
Sany Heavy Industry's acquisition of Putzmeister	700	Germany

Source The Lawyer (Yun Krieglger, "China Light", The Lawyer, 29 October 2012.)

cinema operator (see Footnote 8). The transaction indicates that China's overseas investments are not only focused on energy and manufacturing, but also extends to the cultural industry.

Table 12.1 illustrates that Chinese overseas investment in Europe covered various industries in 2012. Other industries have been viewed as the potential investment areas as well. Another example is that, the world's leading pork producer Smithfield Foods Inc. (SFD), announced in May 2013 that it had agreed to be bought by a Chinese meat-processing company, Shuanghui International Holdings Ltd.<sup>9</sup> In September 2013, SFD announced that US regulators approved the transaction.<sup>10</sup> Today, these investments cover a even wider range; for instance, in 2015, Chinese enterprises conducted 593 overseas mergers and acquisitions, with the transaction volume reaching \$40.1 billion (including overseas financing), covering almost all industries of the national economy.<sup>11</sup>

From these data, it can be seen that, Chinese overseas investment is developing with significant growth. These investments are not only conducted by state-owned companies, but also by the private enterprises. Furthermore, the range of the targeted industrial sectors has become broader than before, covering: agriculture, fishing, energy, natural resources, transportation, manufacturing, cultural, educational, and other sectors.

<sup>9</sup>Elizabeth Broomhall, "International Firms Aim to Cash in on Chinese Companies' Appetite for Outbound M&A Deals", *Legal Week*, 2013, 15(25), 4.

<sup>10</sup>Shruti Date Singh & Bradley Olson, "Smithfield Receives U.S. Approval for Biggest Chinese Takeover", *Bloomberg*, 7 September 2013, <http://www.bloomberg.com/news/2013-09-06/smithfield-receives-u-s-regulator-approval-for-shuanghui-deal.html>, last accessed: 12 October 2013.

<sup>11</sup>Ministry of Commerce (18 January 2016), "Official of the Department of Outward Investment and Economic Cooperation of the Ministry of Commerce Comments on China's Outward Investment and Economic Cooperation in 2015", <http://english.MOFCOM.gov.cn/article/newsrelease/policyreleasing/201602/20160201251488.shtml>, last accessed: 16 September 2015.

Speaking from the international dimension, overseas investment is tightly linked with long-term, sustainable, and ethical development. According to the Organisation for Economic Co-operation and Development (hereafter the OECD) Benchmark Definition of Foreign Direct Investment, “direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor”.<sup>12</sup> In the International Monetary Fund (hereafter the IMF)’s view, direct investment refers to international investment that “reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy”.<sup>13</sup> It can be seen from these definitions that a “lasting interest” in the investment is emphasized.

According to the OECD, the “lasting interest” can be evidenced by “when the direct investor owns at least 10% of the voting power of the direct investment enterprise”.<sup>14</sup> Overseas investment can actually serve as an important and effective vehicle for the development of both local economy and investors. If long-term and ethical investment interests are established, the investment shall promote economic growth. Further to this, in recent years, the sustainable and ethical development has been continually emphasized. Thus, numerous international standards and organizations have been established. For instance, the UN Global Compact works in order to ensure that business activities add value to the bottom line, people, communities, and the planet, through encouraging companies to operate responsibly and take strategic actions that support society.<sup>15</sup> It also suggests companies adopt a comprehensive approach to sustainability and set up five essential elements of corporate sustainability which can be put into practice by companies, namely to operate responsibly in alignment with universal principles, take strategic actions to support the society around them, commit at the highest level, report annually on their efforts, and engage locally.<sup>16</sup>

Nevertheless, when evaluating the performance of Chinese overseas investment, one issue that has been noticed is that the conversation on whether some of these investment activities are conducted according to an ethical approach is not rare, in particular, in the aspects of human rights and environment protection. Given this background, it is quite necessary to examine whether an efficient Chinese regime has been put into action in this area. Among the different issues, the legal regime must be taken into account.

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<sup>12</sup>OECD (2008), OECD Benchmark Definition of Foreign Direct Investment (4th edition). In 1983, the OECD adopted a new “Benchmark Definition of Foreign Direct Investment”, in which adopted a set of rules to improve statistical measures of foreign direct investment. With the continuing reform of international economic situation, in 2008 OECD adopted the 4th edition of Benchmark Definition of Foreign Direct Investment.

<sup>13</sup>IMF (1993), Balance of Payments Manuel, Part XVIII.

<sup>14</sup>OECD (2008), OECD Benchmark Definition of Foreign Direct Investment (4th edition).

<sup>15</sup>UN Global Compact, “Our Strategy”, <https://www.unglobalcompact.org/what-is-gc/strategy>, last accessed: 12 December 2016.

<sup>16</sup>Ibid.

### 12.3 The Legal and Institutional Framework for Overseas Investment

Speaking from a legal point of view, overseas investments are subject to a rigid regime and are required to fulfil different legal requirements. This regime has been enhanced from time to time by the continuing development of regulatory procedures and policies in the world. Taking the year 2011 as an example, according to the United Nations Conference on Trade and Development (hereafter UNCTAD), in 2011, there were at least 44 countries and economies who adopted 67 policy measures affecting foreign investment, in which 52 related to investment liberalization, promotion, and facilitation, and 15 of them introduced restrictive or regulatory measures for foreign investors.<sup>17</sup> These policies included considerations of national security, food security, and industrial policy (see Footnote 17). Furthermore, the regulatory adjustments were not only on the framework level, but also in administrative practice, which included screening procedures for investment and the boarder explanation of national security.<sup>18</sup>

In practice, there are many procedures which overseas investment must go through. Citing the practices of common law systems as an example, a typical acquisition normally involves different procedures, such as planning the deal; gathering information; drafting the principal documents; negotiating the principal documents; exchanging the acquisition agreement; dealing with conditions where the agreement is conditional; completing the deal; dealing with post-acquisition issues. Furthermore, the nature of overseas investment is that Chinese companies are subjected to both of the host and home countries legal requirements. Therefore, there is a relatively rigid regime inside China as well.

From the institutional perspective, along with the Ministry of Commerce (hereafter MOFCOM) and the State Administration of Foreign Exchange (hereafter SAFE), the key institutions involved in these procedures also include the National Development and Reform Commission (hereafter NDRC); and additionally, for the state-owned companies, the State-owned Assets Supervision and Administration Commission of the State Council (hereafter SASAC) plays an important role in the decision-making procedure. The MOFCOM is actively involved in regulating the business of overseas investments; for instance, it has issued the Measures for Overseas Investment Management,<sup>19</sup> Notice of the Ministry of Commerce on Issuing the Overseas Security Risk Early Warning and Information Release System of Foreign Investment Cooperation,<sup>20</sup> and the Administrative Measures for Outbound Investment.<sup>21</sup> Some of the sample requirements will be analysed in detail in the

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<sup>17</sup>UNCTAD (2012), World Investment Report 2012, Chap. IV.

<sup>18</sup>Ibid.

<sup>19</sup>MOFCOM, issued date: 16 March 2009, came into effect: 1 May 2009, repealed.

<sup>20</sup>MOFCOM, issued date: 26 August 2010.

<sup>21</sup>MOFCOM, issued date: 6 September 2014, came into effect: 6 October 2014.

later part of this paper. In this part, the function of the NDRC and SASAC will be examined.

The NDRC is a macroeconomic management organization under the State Council in China. Among other functions, the NDRC also works to approve, authorize, and review key construction projects, foreign-funded key projects, key investment projects for overseas resources development, and investment projects utilizing large amounts of foreign exchange as mandated by the State Council; to guide and supervise the utilization of foreign loans in construction projects; to guide private investment; to study and put forward strategies and plans for foreign capital utilization and overseas investment, as well as targets and policies concerning aggregate balance and structural optimization.<sup>22</sup> Among others, the Interim Measures for the Administration of Examination and Approval of the Overseas Investment Projects<sup>23</sup> and the Measures for the Administration of Confirmation and Recordation of Overseas Investment Projects have played important roles in regulating and adjusting the OFDI.<sup>24</sup>

The SASAC performs investor duties, supervises and manages the state-owned assets of the enterprises under the supervision of the Central Government (excluding financial enterprises), and enhances the management of state-owned assets.<sup>25</sup> The SASAC was founded in 2003 on the basis of consolidation of various other industry-specific ministries. Currently, the State Council, the people's governments of the provinces, autonomous regions, and municipalities directly under the Central Government, and the people's governments at the level of districted city and autonomous prefecture, respectively, set up state-owned assets supervision and administration bodies.<sup>26</sup> As the key player of overseas acquisition, the SASAC and its local office also oversee the protection of state-owned assets. It has also issued a number of documents in the OFDI area; among others, the Interim Measures for the Liabilities of Central Enterprises for Asset Losses is formulated<sup>27</sup>, Interim Measures for the Supervision and Administration of Overseas Investment of Central Enterprises<sup>28</sup> performs

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<sup>22</sup>NDRC Web site, <http://en.ndrc.gov.cn/mfndrc/>, last accessed: 14 October 2013.

<sup>23</sup>No. 21 [2004] of the Order of the National Development and reform Commission, issued date: 9 October 2004, effective date: 9 October 2004, repealed.

<sup>24</sup>No. 9 [2014] of the Order of the National Development and Reform Commission, issued date: 8 April 2014, effective date: 8 May 2014.

<sup>25</sup>Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprises, promulgation date: 27 May 2003, effective date: 27 May 2003, revised date: 8 January 2011. According to Article 13, the main duties of SASAC are: performing the investor's duties and protecting the owner's rights and interests in accordance with the Company Law of the People's Republic of China and other laws and regulations; directing and promoting the reform and restructuring of the state-owned and state-controlling enterprises; dispatching the board of supervisors to the contributed enterprises pursuant to the provisions; appointing and removing, and assessing the principals of the contributed enterprises pursuant to the statutory procedures, and awarding or punishing them according to the assessment results; supervising the value maintaining and increase of the state-owned assets in enterprises through the methods of statistics and auditing, etc.

<sup>26</sup>Ibid., Article 6.

<sup>27</sup>Promulgation date: 18 August 2008, effective date: 1 October 2008.

<sup>28</sup>Promulgation date: 18 March 2012, effective date: 1 May 2012.



important roles in directing and standardizing the overseas investment activities of state-owned enterprises.

It is beyond the scope of this article to examine all the details of these documents; however, one issue needing to be noted is that, in the early stages of overseas investment, there was less concern over the issue of ethical business. It is not difficult to understand that, at the beginning and in the early developing stages of Chinese overseas investment, more attention has been given to the operational aspects, in particular, how to establish a profitable business. Secondly, the risks of overseas investment are not just on the pre-completion stage, but also on the post-merger stage. Compared with the former, post-merger management is a more complicated issue. An overseas investment, ideally, shall pursue the long-term and sustainable investment relationship between the different parties. However, in the past, Chinese companies have little practical experiences of this when operating overseas businesses. Furthermore, there is a lack of experienced personnel who have international experience, understanding both China and host countries, and who can effectively communicate between different parties, in order to promote an ethical business. All the above factors have led to a call to bring ethical business operation into overseas investment, and to be in line with both Chinese and host countries requirements.

## 12.4 Ethical Requirements Under the Chinese Regime

With the more deep and wide operation of the Chinese overseas investment, pressure on conducting business ethically is increased, both domestically and internationally. These companies are under stricter scrutiny than before, by the regimes of China and host countries, as well as international societies. Meanwhile, the inherent interests of operating a long-term successful business require ethics to be considered. Importantly, the Chinese government has also put great emphasis on sustainability, transparency and accountability of business operation.

The concept of ethical development is relatively recent to China. The enactment of the Company Law (1993) and the Securities Law (1998) started to provide the very general principles and guidelines for corporate governance in China.<sup>29</sup> Following this, Chinese law and regulation have further developed the concept and approaches of good corporate governance and sustainable development.

Among different concerns relating to overseas investment, workplace safety is one of the major issues, in particular, for those countries and areas which are undergoing conflict. Along with the operational safety issue at work, personnel (Chinese or staff recruited locally) in the conflict areas may also face personal dangers, such as kidnap,

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<sup>29</sup>Company Law, promulgation date: 29 December 1993, effective date: 1 July 1994. Revised date: 27 October 2005 and 28 December 2013, effective date: 1 March 2014. Securities Law, promulgation date: 29 December 1998, effective date: 1 July 1999. Revised date: 27 October 2005 and 31 August 2014, effective date: 31 August 2014.

personal injuries, or even murder. Consequently, a system for ensuring safety has to be put into place.

In 2009, it has been stated in the Urgent Notice of the General Office of the Ministry of Commerce, General Office of the Ministry of Housing and Urban-Rural Development, and General Office of the State Administration of Work Safety on Further Strengthening the Work Safety of Overseas Investment and Cooperation Projects: “according to incomplete statistics, 6 work safety accidents have occurred in Nigeria, Turkey, Seychelles and other countries during the first quarter of this year, which resulted in 10 deaths and a number of injuries”.<sup>30</sup> Therefore, further improving the workplace safety of overseas projects and preventing workplace accidents became vital concerns for a successful overseas investment. This Notice has pointed out that, there are hidden problems in some of the overseas projects; some enterprises have failed to give enough importance to work safety, and the safety rules are not well established or routinely inspected.<sup>31</sup> Therefore, this Notice requires that the relevant parties conduct a thorough inspection of the potential risks of work safety of overseas projects, improve the bylaws, implement the work safety responsibilities, intensify the long-term evaluation mechanism, and earnestly strengthen the work safety of the overseas projects.<sup>32</sup>

Further to this, in 2010, Notice of the Ministry of Commerce on Issuing the Overseas Security Risk Early Warning and Information Release System of Foreign Investment Cooperation was issued.<sup>33</sup> It particularly requires that early warning against overseas security risks shall be established. It requires that the economic and commercial institutions based abroad, the local commerce departments, and the chambers of commerce (trade associations) shall be responsible for the collection of relevant overseas security risk information in their countries of residence, regions and industries, the classification, analysis and impact evaluation of the foreign investment cooperation, the timely disclosure of early warnings to the relevant Chinese enterprises, and the timely filing of the relevant circumstances with the MOFCOM; the MOFCOM, according to circumstances, will release early warnings through various channels.<sup>34</sup>

Moreover, another issue being discussed commonly is the environmental impacts of Chinese overseas investment. It has been questioned that some of these Chinese investments lack awareness of environmental protection and due consideration of the local communities of the host countries or regions; and even where the environmental commitments have been made, they tend to be superficial. As a result, some of the overseas projects were delayed or suspended. In 2011, the Burmese government suspended the long-planned Myitsone dam and hydroelectric power project, in the

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<sup>30</sup>Letter No. 72 [2009] of the General Office of the Ministry of Commerce, issued date: 20 May 2009.

<sup>31</sup>Ibid.

<sup>32</sup>Ibid., Point II.

<sup>33</sup>MOFCOM, issued date: 26 August 2010.

<sup>34</sup>Ibid., Point II.

face of growing public opposition for social and environmental reasons.<sup>35</sup> This was an investment of the China Power Investment Corporation, and it had been under construction for more than a year. Another example can be found when the Zijin Mining Group's project in Peru had been suspended due to local protests.<sup>36</sup> Apart from economic losses, these incidents have also resulted in the negative social impacts.

In order to enhance the environmental protection behaviours, prevent environmental risks, build up a good image for Chinese enterprises, and provide support to the sustainable development of host countries, MOFCOM and the Ministry of Environmental Protection have published the Notification of the Ministry of Commerce and the Ministry of Environmental Protection on Issuing the Guidelines for Environmental Protection in Foreign Investment and Cooperation.<sup>37</sup> This document has given more specific procedures and guidelines to the operation of overseas investments. It requires that, enterprises should respect the religious belief, cultural traditions and national customs of community residents of the host country; safeguard legitimate rights and interests of labourers; offer training, employment, and re-employment opportunities to residents in the surrounding areas; promote harmonious development of the local economy, environment and community; and carry out cooperation on the basis of mutual benefits.<sup>38</sup>

Furthermore, in order to achieve a "win-win" situation of the interests of corporate and environmental protection, enterprises shall adhere to the concept of environmentally friendly and resource conservation, develop low-carbon and green economies, and implement sustainable development strategies.<sup>39</sup> Thirdly, it requires that, enterprises shall understand and observe provisions of laws and regulations of the host country concerning environmental protection; while for projects which are invested, constructed and operated by enterprises, application shall be filed to local government for permits with respect to environmental protection in accordance with laws and regulations of the host country.<sup>40</sup> Besides the above, one issue needed to be noted is that this document also requires the enterprises to formulate contingency plans for environmental accidents and other emergencies based on the nature, features and possible environmental hazards, and set up a reporting and communication system with local governments, environmental regulatory authorities, the general public that may be affected and the headquarters of the Chinese enterprises; furthermore, the contingency plans shall include the organizational system and responsibilities of

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<sup>35</sup>Rachel Harvey, "Burma dam: Why Myitstone Plan is Being Halted", BBC News, 30 September 2011, <http://www.bbc.co.uk/news/world-asia-pacific-15123833>, last access: 12 October 2016.

<sup>36</sup>Mitra Taj, Marco Aquino (reporting), Leslie Adler (editing), "Police Clash with Opponents of \$1.4 bln Copper Mine in Peru", Reuter, 24 March 2015, <http://www.reuters.com/article/peru-copper-protests-idUSL2N0WQ27O20150324>, last access: 12 October 2016.

<sup>37</sup>Shang He Han (2013) No. 74, Ministry of Commerce of the People's Republic of China and Ministry of Environmental Protection of the People's Republic of China, issued date: February 18, 2013. Article 1.

<sup>38</sup>Ibid., Article 3.

<sup>39</sup>Ibid., Article 4.

<sup>40</sup>Ibid., Article 5.

emergency management, prevention and early warning mechanism, handling procedures, emergency guarantees, and recovery and reconstruction after the emergency.<sup>41</sup>

An issue to be particularly pointed out is that there is a long debate of the transparency problem of the Chinese business circle. This matter has been addressed by these Guidelines. It requires that, enterprises are encouraged to post their environmental information on a regular basis and publish their plans on implementation of laws and regulations on environmental protection, measures taken, and environmental performance achieved, etc.<sup>42</sup> Furthermore, they are also encouraged to strengthen their contacts and communications with the government and environment, regulatory authority of the host country, and actively seek for their opinions and suggestions on relevant issues.<sup>43</sup>

Following the above requirements, this document also advocates enterprises to establish the communication approach and dialogue mechanism for environmental social responsibilities, take the initiative to strengthen contacts and communications with local communities and social groups, and obtain relevant opinions and suggestions through forums and hearings according to requirements of laws and regulations of the host country.<sup>44</sup> Last but not least, enterprises are encouraged to actively participate in and support local environmental public interest activities, propagate the concept of environmental protection, and build a good image.<sup>45</sup> Therefore, this document has established a systemic measurement to ensure that Chinese overseas investment is conducted under an ethical approach.

Moreover, in order to promote the establishment of the ethical overseas business, a “green credit” policy has also been applied. Generally speaking, a green credit policy refers to using loans as a stimulus for environmentally friendly industries or projects and requires commercial banks to decline loans to energy inefficient and polluting enterprises. This policy was firstly developed and applied to the businesses within China. Therefore, the green credit policy, as a domestic policy, was mainly focused on the domestic investments, but had not given enough attention to the overseas investments in the past. To address this issue, the Notice of China Banking Regulatory Commission on the Printing and Circulation of Green Credit Guidelines requires that banking financial institutions shall strengthen the management of environmental and social risks associated with overseas projects to which they intend to extend credit, ensure that the promoters of the projects comply with environmental protection, land, health and security laws and regulations of the domiciled countries or regions, undertake in public to adopt relevant international practices or international standards for the overseas projects to which they intend to issue credit and ensure that the operation of those projects is consistent with international best practice.<sup>46</sup>

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<sup>41</sup>Ibid., Article 14.

<sup>42</sup>Ibid., Article 18.

<sup>43</sup>Ibid., Article 19.

<sup>44</sup>Ibid., Article 20.

<sup>45</sup>Ibid., Article 21.

<sup>46</sup>China Banking Regulatory Commission, issued date: 24 February 2012, effective date: 24 February 2012. Article 21.

It can be seen from above analysis that the Chinese legal regime for promoting the operation of ethical business has been primarily established. The selected sample law and regulation cannot fully represent all the perspectives of this regime. However, it is not difficult to find that the essential requirements and procedures have been put into place. The next important step for establishing the successful overseas investment is that how to efficiently employ this regime into practices and eventually achieve ethical and sustainable businesses.

## 12.5 Requirements Under the Industrial Guidelines

The practice of ethical business has been continuously enhanced by recent industrial guidelines. Various industrial initiatives have also been launched in order to address this area. Among others, in 2012, the Chinese Electronics Standardization Association (hereafter the CESA) published Social Responsibility Guidance for Chinese Electronic and Information Industry.<sup>47</sup> This guidance was jointly drafted by the organizations and enterprises organized by the Committee on Social Responsibility of the CESA.

The main drafting team included the CESA, China National Textile and Apparel Council, China Electronics Standardization Institute, China Electronics Technology Group Corporation, China Electronics Newspaper, China Computer Newspapers, Lenovo Group, EMC (China) Co. Ltd., Samsung (China) Investment Co. Ltd., and Nokia (China) Investment Co. Ltd.<sup>48</sup> This document encourages relevant enterprises and organizations to respect human rights; improve people's livelihood; protect environment; maintain market order; establish a fair and reasonable supply chain; improve the internal competitiveness of enterprises and organizations and the international competitiveness of the whole industry; and promote sustainable development of the industry and society.<sup>49</sup> Although it was not specially drafted to deal with overseas investment, as an industrial guidance, it has a great impact on the operation of the relevant Chinese enterprises, either domestically or internationally.

A further move in this field was made by the China Chamber of Commerce of Metals, Minerals & Chemicals Importers & Exporters. The Guidelines for Social Responsibility in Outbound Mining Investments was designed to specifically focus on the Social Responsibility issue of outbound mining investments.<sup>50</sup> This document is aimed at supervising the relevant Chinese mining investments and operations, and guiding Chinese companies in improving corporate social responsibility and sustainability strategies, as well as management systems.

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<sup>47</sup>The Social Responsibility Committee of the Chinese Electronics Standardization Association (2012).

<sup>48</sup>Ibid., Preface.

<sup>49</sup>Ibid.

<sup>50</sup>China Chamber of Commerce of Metals, Minerals & Chemicals Importers & Exporters, October 2014.

Divided into three chapters, these Guidelines state the scope of the Guidelines and define the guiding principles of social responsibility (Chapter One), outline the requirements of social responsibility for outbound mining investments (Chapter Two), and explain how these Guidelines are to be implemented and monitored (Chapter Three). These guidelines are applicable to all mineral exploration, extraction, processing and investment cooperation projects, including related activities such as mining and infrastructure development in the countries in which Chinese companies have invested.<sup>51</sup>

In this document, the “social responsibility of Chinese outbound mining investment” refers to that companies should proactively consider legal, ethical, social, and environmental factors in their decision-making processes and operations; by practicing ethical and transparent operations, the companies must thoroughly respect the rights and interests of stakeholders, effectively manage the social and environmental impacts that result from mineral exploration, extraction, processing, investment, and related activities, and strive for harmonious mineral development operations.<sup>52</sup>

It contains seven guiding principles which require the implementing companies to commit to; namely, ensure compliance with all applicable laws and regulations, adhere to ethical business practices, respect human rights and protect the rights and interests of employees, respect nature and protect the environment, respect stakeholders, strengthening responsibility throughout the extractive industries value chain, and strive for transparency (see Footnote 52). More specifically, Chap. 2 in detail states the corporate social responsibility requirements for overseas mining investments from the following aspects: organizational governance, fair operating practices, value chain management, human rights, labour issues, occupational health and safety, environment, and community involvement and engagement.<sup>53</sup> For instance, in order to promote corporate social responsibilities during the value chain management, companies shall require and support first-tier suppliers to adhere to the principles and requirements set out in the Guidelines and leverage first-tier suppliers to enforce the Guidelines; set targets for responsible procurement and formulate relevant company policies; set clear targets for localized procurement, indicating which and how many supplies will be purchased from the host country, from the local mining communities and from abroad; adopt a due diligence and internal control system to assess risks in the supply chain, if the company is engaged in upstream activities of mineral development (e.g. processing, trading, or sourcing from artisanal miners or cooperatives).<sup>54</sup>

It can be seen from above analysis that this document has established a comprehensive and effective approach to enhance the ethical operation of the overseas mining industry. It particularly needs to be noted that along with Chinese law and regulation, these Guidelines were structured in line with the principles and core subjects of the ISO 26000 Guidance on Social Responsibility with some exceptions to

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<sup>51</sup>Ibid., Chap. I.

<sup>52</sup>Ibid.

<sup>53</sup>Ibid., Chap. II.

<sup>54</sup>Ibid., Article 2.3.

**Table 12.2** Prioritized types of minerals and related products

Type	Details
Gold	Metals (including derivative metals), minerals, ores and mineral concentrates that contain gold
Tin	Metals (including derivative metals), minerals, ores and mineral concentrates that contain tin (cassiterite and other tin minerals)
Tungsten	Metals (including derivative metals), minerals, ores and mineral concentrates that contain tungsten (wolframite and other tungsten minerals)
Tantalum	Metals (including derivative metals), minerals, ores and mineral concentrates that contain tantalum (Tantalite, Coltan and other Tantalum minerals)

*Source* According to the Chinese Due Diligence Guidelines for Responsible Mineral Supply Chains (Ibid., Part III.)

reflect the specifics of the mining industry; the Ten Principles of the United Nations Global Compact and other international standards and initiatives.<sup>55</sup> Therefore, this document can more effectively meet the special needs of the mining industry; as described by itself: “as a capital-intensive long-term business, the sustainable development of mineral resources requires continuous public trust and a stable legal, political, social, and economic environment”<sup>56</sup>

Following this, in order to further enhance ethical operation, the Chinese Due Diligence Guidelines for Responsible Mineral Supply Chains was issued by the China Chamber of Commerce of Metals, Minerals & Chemicals Importers & Exporters.<sup>57</sup> This document is aimed at providing guidance to those companies who are extracting or using mineral resources and related products and are engaged in the supply chain of minerals, to identify, prevent, and mitigate the risks of directly or indirectly contributing to conflict, serious human rights abuses and risks of serious misconduct.<sup>58</sup>

More specifically, these Guidelines apply to all Chinese companies which are extracting, trading, processing, transporting, or otherwise using mineral resources and their related products and are engaged at any point in the supply chain of mineral resources and their related products (see Footnote 59). Furthermore, in terms of the “mineral resources”, in these Guidelines, it refers to all mineral resources and their related products (i.e. ores, mineral concentrates, metals, derivatives, and by-products).<sup>59</sup> Nevertheless, at the beginning stages, the authority will prioritize releasing audit protocols and supplementary materials covering the supply chains of the followings (Table 12.2).

Furthermore, in the Guidelines, two kinds of risks (Type 1 and Type 2) are defined. Type 1 risks are risks of contributing to conflict and serious human rights abuses asso-

<sup>55</sup>Ibid., Forward.

<sup>56</sup>Ibid.

<sup>57</sup>The China Chamber of Commerce of Metals, Minerals and Chemicals Importers & Exporters, issued date: 2 December 2015.

<sup>58</sup>Ibid., “About these Guidelines”.

<sup>59</sup>Ibid., Part III.

**Table 12.3** The five-step due diligence framework

Number	Steps
Step 1	Establish strong company risk management systems
Step 2	Identify and assess risk in the supply chain
Step 3	Design and implement a strategy to respond to identified risks
Step 4	Carry out independent third-party audit at identified choke points in the supply chain (as indicated in the Audit Protocols)
Step 5	Report on the process and results of supply chain risk management

*Source* Chinese Due Diligence Guidelines for Responsible Mineral Supply Chains (Ibid., Part IV.)

ciated with extracting, trading, processing, and exporting of resources from conflict-affected and high-risk areas; for instance, any forms of torture, cruel, inhuman and degrading treatment; war crimes, other serious violations of international humanitarian law, or crimes against humanity or genocide; engaging in money laundering resulting from or connected to the extraction, trade, processing, transport, and export of mineral resources derived from the illegal taxation or extortion of mineral resources at points of access to mineral extraction sites, along transportation routes or at points where mineral resources are traded by upstream suppliers.<sup>60</sup> Type 2 risks refer to risks relating to serious misconduct in environmental, social and ethical issues; for instance, breaking Chinese or host country laws and regulations or industry minimum standards; employing children under the minimum working age of the host country laws and regulations, or where there is no relevant law or regulation, employing children below the minimum working age of 16 years; extracting or sourcing resources from mining operations where the culture and heritage of local communities and indigenous peoples have not been respected and protected, or where traditional cultures of local peoples have been harmed (see Footnote 60).

Importantly, this document provides a five-step model for carrying out risk-based supply chain due diligence, as Table 12.3 shows. Based on this model, the companies can effectively establish the relevant procedures to conduct due diligence, in order to reduce or mitigate risks. One particular point shall be pointed out is that these Guidelines do not merely give guidance on general scope but also make specific suggestions to the upstream and downstream companies. For example, when discussing the establishment a system of controls and transparency over the mineral supply chain, this document requires that the upstream companies should establish an appropriate chain of custody or a traceability system over mineral production and trade, and pass on the relevant due diligence information downstream; they are also encouraged to engage with downstream companies and request that the latter conduct due diligence themselves, or encourage downstream companies to source from companies that are conducting due diligence or work with their suppliers to conduct due diligence.<sup>61</sup>

<sup>60</sup>Ibid., Part V.

<sup>61</sup>Ibid., Part VII.



At the same time, for the downstream companies, this document requires that they should establish transparency systems over the supply chain to collect data on key upstream actors in the supply chain, and the countries and regions they source from (see Footnote 61).

As can be seen from above discussion, this document applies to all Chinese companies which are engaged in both the upstream and the downstream parts that are engaged in using mineral resources and their related products of the supply chain. Moreover, drafted based on the UN Guiding Principles on Business and Human Rights and the OECD Due Diligence Guidance on Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, these guidelines are expected to promote the integration and coordination with other related standards, regulations, and initiatives.<sup>62</sup> Consequently, based on above all factors, together with a proper application, this document has set a comprehensive regime for the Chinese mining companies for enhancing ethical and fair operations, improving labour conditions, minimizing environmental hazards, avoiding conflicts, and creating a better life for the local community where their investments are located.

## 12.6 Conclusion

From the above analysis, it can be seen that, compared with previously, more attention has been placed on the ethical operation of Chinese overseas investment. Although it is still a relatively new area, it is not difficult to foresee that more emphazises and efforts will be given to this area. This issue has not only drawn the attention of governmental bodies, industries, civil societies, and academics, but also become an inherent requirement for the further development of business. It is also noted that the strategy to establish ethical overseas investment has moved from protecting investment and personnel to giving more environmental and other ethical considerations and benefits to the host countries. Although concerns now may rise as whether these companies will conduct double standard businesses between host and home countries; however, based on the previous experiences of applying advanced practices back to China, such as the overseas listing of Chinese banking industry which has subsequently introduced some new practices to China, a positive prospective has been emerged gradually.

On the other hand, it shall be noticed that to achieve and fully establish the ethical business is not an easy task. As the regime for promoting ethical operation in the overseas investment has been primarily established, the next major task is to transfer the regime into long-term practices. It shall be borne in mind that conducting the ethical business is not only a policy issue but also shall be every enterprise's natural concern. From the enterprises' perspective, this shall not be a mere legal or regulatory matter, but more directly, an inherent requirement for business operation. This is because the successful business will need the understanding and support from the

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<sup>62</sup>Ibid., "About these Guidelines".

local countries and communities. Therefore, the next stage for the ethical operation of overseas investment shall be that the companies can transfer their ethical actions from being traditional legal or regulatory motivated to being impacts motivated.

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**Part IV**  
**Country Analysis**

# Chapter 13

## Precepts of Business Ethics on the Romanian Market



Larissa Batrancea, Anca Nichita and Ioan Batrancea

### 13.1 Introduction: Business Ethics Under the Historical Lens

“Errare humanum est,” rendered as “To err is human” (Strauss 1998: 57; Fellmeth and Horwitz 2009), is one of the teachings that the Latins bequeathed to us through the writings of Seneca. The excerpt is often used when referring to the vulnerability of human nature, which is prone to errors and should therefore be leniently regarded. Considering the decision-making process within the business environment, could any type of business error be disregarded?

As Solomon (1997: 16) puts it, ethical errors are considered by far the most jeopardizing for a business career and, consequently, the least acceptable. While industrial, marketing, management, or even accounting errors can be solved in a relatively subdued manner, breaches of ethical principles make it to the agenda of the general public extremely quickly and affect the reputation that a company has strived to create on the market. The rationale is straightforward. The long-term development and expansion of business relations depend heavily on companies’ reputation and trustworthiness in the eyes of the state, clientele, suppliers, potential investors, and ultimately shareholders. On the assumption that businesses are generally started for generating turnover in the long run, defaulting on both signed contracts and verbal agreements based on trust results in suspicion, disbelief, and ultimately the closure of any business transactions, be it with public authorities, clients, employees, providers, or company investors. Using the game theory framework, it could be stated that businesses—as complex economic activities—represent infinitely repeated games in which reputation is the key element (Chatterjee and Samuelson 2001). Especially in the business environment, reputation plays a crucial role on the basis that it connects “past behavior with expectations of future behavior” (Mailath and Samuelson 2006: 459).

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Profit maximization is often considered to be the main goal of running a business (Van Horne 2001). Nevertheless, the importance of aspects like social responsibility, sustainable development, and business ethics have been gaining ground worldwide during the last decades (Rendtorff 2009; van Drimmelen 2013; Sternberg 2001). Nowadays, a company's achievements and the manner of obtaining them are equally important (McGuire et al. 1988; Nayar 2009), especially when taking into account the environmental limits (NEF 2012) and people's concern for individual well-being (OECD 2014). Consequently, while operating on interconnected highly competitive markets, economic agents are called to find a balance between securing lucrative operations, satisfying increasingly demanding clients, and complying with ethical precepts.

The literature on business ethics is extremely developed (De Cremer and de Bettignies 2013; DesJardins 2011; Enderle 2015; Ferrell et al. 2013; Gilbert 2012; Tsalikis and Fritzsche 1989; Weiss 2014), and it often draws inspiration from ancient philosophical inquiries (Luetge 2012). As a case in point, starting from the writings of Aristotle, de Bruin (2015: 1) recounts in the beginning of his work that the inception of finance was marked by Thales the Milesian. Considered to be among the first philosophers and mathematicians, Thales was also the first grantor of an option contract. Six months in advance, he predicted an upcoming abundant olive crop and secured—with a relatively low amount of money—the right to exclusively use all the olive presses in the city (Poitras 2009). Due to the accuracy of his predictions, he became rich by selling to the olive growers the right to use the presses.

Scrutinizing the story of Thales the Milesian, the questions which arise are the following: How can an ethical decision be defined? Which is the line between ethical and unethical business actions? Are ethical principles valid throughout the world? Does culture shape the framework of ethical principles? This is where business ethics enters the scene and attempts to answer these questions and related ones.

In the following chapter, we tackle concepts of business ethics and critically examine the precepts driving business decision-making on the Romanian market. In addition, we will analyze the degree to which consumers, professionals, and businesses operating in Romania incorporate ethics principles into their interactions with state authorities, business partners, employees, and clients.

## 13.2 General Considerations on Business Ethics

Prior to briefly addressing general aspects regarding business ethics, we will highlight the difference between ethics and morality, as the two concepts are often regarded as synonyms.

Morality, which may operate under deontological or consequential paradigms (Batrancea et al. 2014), deals with “a set of deeply held, widely shared, and relatively stable values within a community” (Horner 2003). In the opinion of Horner, philosophical inquiries about ethics are based on value examination, while applied ethics encompasses “the use of ethics principles in actual situations.” According

to Ambrose and Cross (2009: 3–5), ethics is an inquiry field that focuses on the concept of right conduct and the “nuances of moral behavior.” Therefore, the distinction between ethics and morality mirrors the existing difference between theory and practice: while ethics ingathers “theories of right conduct,” morality designates the “practice of right conduct.” In the same vein, Boldizar and Korhonen (1999: 285) remark that ethics entails an ability to undertake difficult situations and it studies “the decision regarding whether to apply a given code or standard in particularized circumstances.” Analyzing the aforementioned characteristics, one might conclude that ethics could be considered a morality law.

Ethical precepts constitute the core research topic of various interdisciplinary fields such as financial ethics (Boatright 2014; Dobson 1997; Sternberg 1996), business ethics, law ethics, or medical ethics. On the account that the intense global market competition, the commoditization of financial services, and the mitigation of profit margins make financial institutions susceptible to breaches of ethical principles and various forms of corruption (Lamb 1999: 13), the ultimate goal of financial ethics is the development of fair trade practices within financial markets. For this purpose, financial ethics covers the principles of trading money, economic entities, and other financial products (Rendtorff 2009: 202). Simply put, the field considers financial decisions as “given and examines their moral status” (Aragon 2011: 2).

Whereas financial ethics focuses solely on the dynamics of financial markets, *business ethics* is a more comprehensive field, rooted in applied ethics. Being a nascent but formal discipline (Buckley 2013; Callaghan and Wood 2014; Carroll and Buchholtz 2015; Carson 2003; Chan et al. 2010; Crossman and Doshi 2015; Stark 1993; Svensson and Wood 2008; Treviño and Nelson 2011; Weiss 2014), business ethics advances a set of precepts that economic entities should adhere to with the purpose of acting ethically (Kolb 2008: IXvii). Undoubtedly, ethical principles should characterize all elements related to developing a business, starting with the marketed product or service and continuing with marketing strategies, staff policies, employees’ benefits, third-party relationships (i.e., state authorities, clients, business partners), or environmental concerns.

As Audi (2010: 48) observes, business ethics is intertwined with legal ethics because it scrutinizes the degree to which local and foreign investors run their businesses in accordance with the legal framework of the national market on which they operate. According to the same author, business ethics poses *internal questions*, focused on the relationship between managers and subordinates, and also *external questions*, focused on the relationship with third parties outside the economic entity (Audi 2010: 54–55). As a case in point, the set of internal inquiries might regard aspects like equal treatment of employees, their rights and obligations, language appropriateness when dealing with subordinates. In the set of external inquiries, one might include the company’s responsibility toward its clientele and the environment, the veracity of marketing strategies, the use of improper business influence through gift-giving, the employment of aggressive accounting, and tax planning tactics (using legal loopholes) in order to mitigate the tax burden.

When talking about the approach of managers toward subordinates, Gill (2009) notes that employees’ work behavior is shaped by the hierarchy and the conduct code

of the economic entities where they activate. If the management team leads through micromanagement and overregulation, employees are impeded from taking decisions on their own and, in addition, they do not internalize the regulatory framework.

With respect to the marketing strategies, Vaux (2013) states that companies following the “letter and the spirit” of ethical precepts design honest advertising campaigns, refrain from incorporating subliminal messages into the advertisement, market products that can be distinguished from the ones of their competitors, avoid exploiting society stereotypes (i.e., are socially conscious) and manifest concern for the environment (i.e., are environmentally conscious).

### 13.2.1 *Business Ethics Index*

As previously stated, developing a business starting from ethical principles defines its success and presence on the market. If a company is perceived to be ethical in relation to the employees, customers, and business partners, it manages to preserve its reputation in the long run. With respect to this, ethicists have proposed an instrument for assessing business behavior, which was labeled *business ethics index* and was created starting from empirical research conducted in the USA (Tsalikis and Seaton 2006, 2007a; Tsalikis et al. 2011).

The business ethics index synthesizes two well-established measurement instruments targeting consumer sentiment: the University of Michigan’s Index of Consumer Sentiment and the Conference Board Consumer Confidence Index. It comprises four items that are built along two dimensions (Tsalikis and Seaton 2006: 319): (1) personal—vicarious; (2) past—future. The first dimension assesses the ethical behavior of companies based on personal experiences and others’ opinion or media reports. The second dimension captures personal expectations and past experiences regarding the ethical behavior of companies.

The detailed structure of the business ethics index is presented in Table 13.1.

The first two items register values on a 5-point Likert scale, from 1 = “very unethically” to 5 = “very ethically.” The last two items register values on a 3-point Likert scale, with 1 = “more unethically” to 3 = “more ethically.” A business ethics index below the 100 benchmark indicates that consumers perceive business behavior as unethical, while an index above 100 shows that business behavior is perceived as ethical.

For a decade, the business ethics index (i.e., BEI) has been widely used to assess ethical behavior in various societies around the world, marked by different cultural dimensions. As expected, the overall BEI scores vary across surveyed countries, most probably due to cultural differences (among other influencing factors). With regards to this variation source, Trompenaars and Hampden-Turner (1998: 3) state that “in every culture in the world such phenomena as authority, bureaucracy, creativity, good fellowship, verification, and accountability are experienced in different ways. That we use the same words to describe them tends to make us unaware that our cultural biases and our accustomed conduct may not be appropriate or shared.” In the same



vein, Moran and Abramson (2014: 6) assert that “cultures have always been distinct, mostly separate and independent. Over the past 100 years, and especially during the last 25, culture and nations have remained unique, but have become increasingly more interconnected in complex and nonobvious ways.”

Starting from the existing literature on the business ethics index measurements around the world, we have compiled the subsequent figures (Figs. 13.1 and 13.2) presenting both the overall and detailed BEI scores. Taking into account that participating countries were surveyed in different waves and that some countries were included in more than one wave, we have considered the most recent business ethics assessments.

As can be observed from Fig. 13.1, most surveyed countries registered scores above 100, meaning that the business environment was perceived rather ethical. On the one hand, the outliers in terms of positive consumer sentiments were three Latin American countries (i.e., Brazil, Colombia, Mexico) and Russia. On the other hand, the outliers in terms of negative consumer sentiments were Egypt, India, and Turkey. The BEI scores detailed on each component of the index and presented in Fig. 13.2 may provide additional insights for the overall BEI scores.

Figure 13.2 indicates that, except for Turkey, all 16 countries registered the lowest scores for the BEI\_VP item. The consumer sentiment pattern was constant across the country pool: under the influence of the mass media or personal acquaintances, consumers reported more critical assessments of ethics in the business environment compared to their own experiences (BEI\_PP). In other words, sometimes people have the tendency to interiorize faster opinions released by the media or acquaintances and overlook personal experiences.

Additionally, the graph shows that BEI\_PF and BEI\_VF register very similar scores. Namely, participants projected a more ethical business environment starting from personal experiences or cases signaled in the press. While they could segregate quite easily between past experiences, the nearly identical future scores might imply

**Table 13.1** Variables of the business ethics index

Variable content	Dimension type
<b>Item 1:</b> Based on your own experience as a consumer in the past year, businesses you dealt with generally behaved...	<i>Personal/Past (PP)</i>
<b>Item 2:</b> Based on what you heard from others or in the media in the past year, businesses behaved...	<i>Vicarious/Past (VP)</i>
<b>Item 3:</b> Based on your own experiences as a consumer last year, do you expect business in the coming year to behave?	<i>Personal/Future (PF)</i>
<b>Item 4:</b> Based on what you heard from others or the media last year, do you expect businesses in the coming year to behave?	<i>Vicarious/Future (VF)</i>

Source Tsalikis and Seaton (2006: 324)

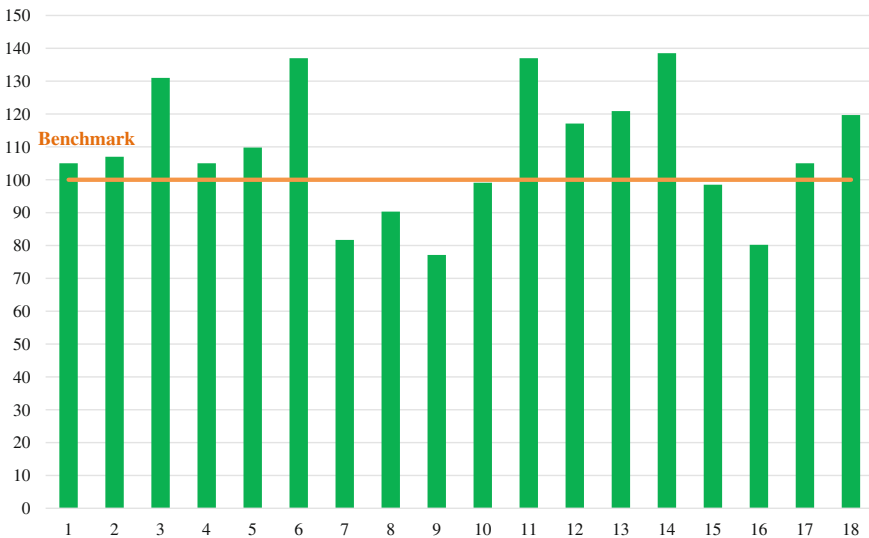
that consumers had more positive expectations about business ethics in the upcoming years.

### 13.2.2 Key Aspects in Business Ethics

Regarding the connection between law and ethics in general, Sims (2003: 22) states that the law may be regarded as “a reflection of what society thinks are minimal standards of conduct and behavior” (in other words a “codified ethics”), while ethical behavior is deemed “to reside above behavior required by the law.”

In our view, a first key aspect of ethical business behavior is performing economic activities following the law, particularly by focusing on *compliance with both its letter and spirit*. According to Garcia et al. (2014: 479), the letter of the law is defined as “its literal meaning,” while the spirit of the law is deemed as the “perceived intention of the law.” For Ostas (2004), the spirit of the law emerges from a set of rules pointing out the ethical and social standards that are secured by the letter of the law. Hence, business endeavors succeed in guiding their development based on ethical principles if profit is secured within the legal framework and without speculating the potential loopholes of the law.

Like previously mentioned, ethics may be regarded as a law of morality. On the account that moral considerations are related to long-term outcomes, ethical



**Fig. 13.1** Overall scores of the Business Ethics Index (BEI). *Source* BEI scores were retrieved from: Tsalikis and Fu (2010: 82), Tsalikis and Seaton (2007b: 234, 2008a: 923, 2008b: 383, 2014: 211), Tsalikis et al. (2008: 647)



**Fig. 13.2** Detailed scores of the Business Ethics Index (BEI). *Source* BEI scores were retrieved from: Tsalikis and Fu (2010: 82), Tsalikis and Seaton (2007a: 234, 2008a: 923, 2008b: 383, 2014: 211), Tsalikis et al. (2008: 647)

reasoning determines businessmen to put short-term interests aside (Hendry 2013: 42). Therefore, another key aspect to be considered in the business environment is *ethical responsibility*, which can be defined as a set of guidelines applied for running and protecting the business (including employees, customers) and society. In light of ethical responsibility, owners and managers of an ethical business aim to create value added for society as a whole and not on the expense of society. Van Liedekerke et al. (2000: 3–4) indicate three types of ethical responsibility, in accordance with the level at which they appear: professional deontology (individual level); corporate conduct (institutional level); ethics of worldwide financial systems and regulations (global level). One can say that a business is indeed ethical when it successfully implements principles of ethics at all its levels. For instance, each employee (managers, ordinary staff) has to accomplish duties respecting the norms, rules, and obligations stipulated by her profession and can be held accountable based on professional deontology. Furthermore, all employees have to interact with owners, co-workers, clientele, business partners, and state authorities in a standard formal manner according to the company ethics code. Ultimately, businesses developing globally have to follow international regulations concerning environment protection, employee rights and benefits, product quality, taxation.

Another key ingredient without which ethics in the business environment cannot be pictured is *trust*, a strong belief the trustor has in the reliability and reciprocity of the trustee. Either it is vertical (i.e., political), in which case it describes interactions with public authorities, employees, and clientele (Hadjikhani and Thilenius 2005: 138) or horizontal, when characterizes interactions with co-workers and other business partners, trust constitutes a real catalyst for business relationships and con-

ditions their length in time. As a non-material business asset, trust is difficult to be built, yet extremely easy to be shuttered. Although it may be affected by the short-term gains mirage, in the long run trust proves to be invaluable for the success of any business. Based on trust (which is backed of course by binding agreements), businessmen associate with others, start economic activities, look for potential new investors, enter new markets or hire personnel. On the same rationale, regular individuals enter the labor market as employees or buy products and services as clients of these economic activities.

Closely linked to trust is the concept of *trustworthiness*, or the ability of the trustee to be reliable and to reciprocate to another person's trust. In the business world, the trust of employees, investors, or clients is gained in the long run only if companies prove their trustworthiness. One strategy to achieve this implies incorporating in company mission statements ethical precepts or the support offered toward social issues (Bartkus and Glassman 2008). Another strategy is based on developing powerful brand names. According to Miller (2003: 19), "an expensive brand name is a hostage to honesty—a hostage that dies if customer trust is lost." In his opinion, massive branding investments are generally done by companies with a long-term thinking, interested to permanently activate on the market.

### ***13.2.3 To Pay or not to Pay Taxes: Ethical Considerations Within the Tax Game***

One of the aspects triggering discussions over business ethics is tax behavior, mainly on the account that managers have to ensure the increase of shareholders' wealth while following the tax laws of the countries in which they operate. When tax codes leave room for interpretation due to exiting loopholes, some managers aim to achieve shareholders' goals by decreasing tax burdens. The extent to which strategies of reducing tax levies qualify as ethical will be discussed in the following paragraphs.

According to the literature (Kirchler 2007), the taxonomy of tax behavior comprises two main behavioral types, i.e., tax compliance and tax noncompliance. Tax compliance translates into following "the letter and the spirit" of the law (James and Alley 2002). Based on the aforementioned (see subchapter "Key Aspects in Business Ethics"), complying with the tax code represents an ethical behavior.

A taxpayer's behavior qualifies as tax compliance only if certain stages are fully accomplished (Fig. 13.3).

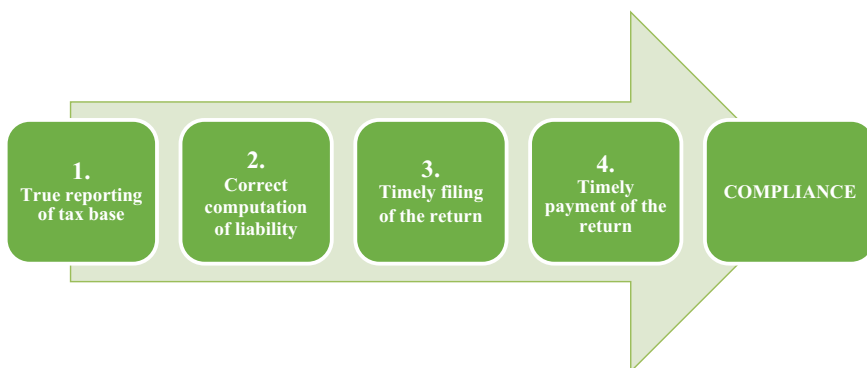
In the first stage, a taxpayer has to honestly disclose all taxable revenues, so that the fair share will be transferred to public authorities and thus finance public goods provision. In the case of individual taxpayers, honest disclosure implies that they declare every taxable revenue which is not otherwise subject to a withholding system. With regards to corporate taxpayers, they would have to register all employees for tax purposes and refrain from perpetuating practices like moonlighting to decrease the tax base.

The second stage implies that taxpayers determine correctly the amount of taxes due. Considering the intricacy of tax legislation and the high level of education required for proper understanding (Lewis 1982), many taxpayers secure the correctness of tax reports by hiring tax consultants. For a case in point, 75% of Australian taxpayers (Sakurai and Braithwaite 2003) and 60% of Americans (Blumenthal and Christian 2004) use the services of tax consultants for adequately compiled tax returns.

The third stage requests that taxpayers file taxes according to the tax calendar set by authorities. It goes without saying that complying with tax deadlines depends a lot on the structure of the tax system and the degree of red tape defining it (e.g., number of tax payments, number of hours needed to comply, total tax rate; World Bank Group & PricewaterhouseCoopers 2015). In this stage, electronic tax filing systems facilitate the compliance process.

The fourth and last stage assumes that contributors have to pay taxes on time in order to avoid notifications from tax authorities, penalties, or even interest. With the purpose of incentivizing taxpaying before deadlines, some national tax authorities implement “carrot”-based strategies (Widdowson 1998) and reward contributors decreasing the amount of taxes due by a small percentage. Other national tax authorities also employ “stick”-based strategies and list on their official webpages the name of noncompliant taxpayers (i.e., “naming and shaming” strategy; Devos and Zackrisson 2015).

As previously mentioned, a taxpayer’s behavior is regarded to be compliant only when the taxpayer follows all four stages. Otherwise, the behavior falls into the category of tax noncompliance. According to empirical research conducted on tax behavior (Kastlunger et al. 2013; Kirchler et al. 2008, Kirchler et al. 2014; Kogler et al. 2013; Muehlbacher et al. 2011; Wahl et al. 2010), tax compliance can be either *voluntary* or *enforced*, depending on whether taxpayers perceive authorities as trustworthy or powerful.



**Fig. 13.3** Four mandatory stages of the tax compliance process. *Source* Designed based on Franzoni (2000: 55)

Tax noncompliance also includes two behavioral subtypes, i.e., tax avoidance and tax evasion. The former is based on mitigating the amount of taxes owed by using the loopholes into the law (Webley 2004). Although tax avoidance is legal, i.e., it follows the letter of the law, from the standpoint of ethics it disregards the spirit of the law, which makes it unethical (Institute of Business Ethics 2013: 1). From a legal perspective, drawing the line between acceptable and unacceptable tax practices is extremely challenging, especially when it comes to tax avoidance (Wilkinson 2015).

In our view, the fundamental problem comes from the fact that corporate taxpayers can leverage taxpaying benefits which individuals do not possess (e.g., amortization, provisions tax write-offs for business expenses, tax-deductible charitable contributions, exemptions from labor taxes for hiring young people or seniors, limited period exemptions from corporate tax for investments made in key economic sectors etc.). Starting from these benefits, corporate taxpayers seldom take advantage of the existing legal shortcomings with the help of professional tax advisors and go to great lengths in order to mitigate tax payments. Yet, aware that tax avoidance rumors may affect their reputation, some companies try to project into the media their commitment toward social responsibility (Sikka 2012: 60).

Despite such attempts, the reality is that large shares of the tax gap are caused by tax avoidance. For instance, in the period 2013–2014, tax avoidance accounted for 8% of the UK tax gap, while tax evasion accounted for 13% (HM Revenue & Customs 2015).

During the last decade—to say the least, the global business environment has witnessed many situations in which thriving multinationals were exposed in the media for aggressive tax avoidance schemes (i.e., involving tax havens, transferring prices etc.) which allowed them to pay no taxes while generating hundreds of millions of dollars in profit. Disregarding ethical precepts, these economic entities have legally deprived national budgets of substantial tax revenues that otherwise might have been used to finance public goods systems. In many cases, tax avoidance allegations have triggered clients' resentment, product boycotts, and public image damages.

As rational players of the tax game, individual taxpayers are very much aware that companies exist primarily to create value added through their employees and to generate profit. Notwithstanding this, breaches of ethical precepts are rarely tolerated on the basis that companies have to manifest respect for their clientele and the market on which they operate.

In many countries around the world, tax authorities and international bodies (e.g., Australian Tax Authority, European Commission, HM Revenue & Customs) have started taking measures to cap tax avoidance schemes and educate people to denounce such practices. In some cases, tax laws were revised, simplified and updated to mirror the current business realities.

Compared to tax avoidance, tax evasion is illegal and refers to mitigating tax burdens by breaking the law (Elffers et al. 1987) through acts of omission or commission (Kirchler 2007: 22). The first category usually includes acts that can be done out of ignorance (Spranca et al. 1991: 76), such as not reporting small lottery winnings for being unaware of the law. Yet, as the Latins said, *ignorantia juris non excusat*

(i.e., “ignorance of law excuses no one”). The latter category comprises acts that are deliberately performed with the purpose of not abiding by the law, such as not issuing receipts for every sale or using moonlighting to mitigate payroll taxes. Tax evasion acts go against the letter and the spirit of the law, thus being unethical.

It is acknowledged that tax behavior is subject to a multitude of influences, from economic reasons to socio-psychological considerations (Kirchler 2007). Among these factors, ethics plays an important role within the tax game, because it often marks the line between compliance and noncompliance. In this respect, it is argued that compliance decisions cannot be completely grasped outside the ethics spectrum of judgments and beliefs. The argument is extremely compelling:

Still, the puzzle of tax compliance is not why there is so much cheating. Instead, the real puzzle is why there is so little cheating. Typically, the percent of all individual income tax returns that are audited is often less than 1%, and the penalties on even fraudulent evasion are only a fraction of unpaid taxes. Virtually all economic models of taxpayer behavior conclude that there should be more tax evasion than actually observed. However, most people pay most of their taxes most of the time. The puzzle of tax compliance is to explain why people pay taxes. (Alm and Torgler 2011: 635)

In the same vein, Reckers et al. (1994) report that tax ethics significantly influences compliance decisions: taxpayers are less willing to engage in tax evasion whenever moral aspects are taken into consideration.

When it comes to ethics, corporate taxpayers should address tax issues and their view on taxpaying in the company ethical code. This way, potential investors could become acquaint with the company’s tax practices and decide knowledgeably whether to finance the business or not.

## **13.3 Particularities of Business Ethics in Romania**

### ***13.3.1 Ethical Precepts of Public and Private Institutions***

The following subchapter highlights sets of ethical precepts that guide institutions and businesses activating in the public and private economic sectors in Romania.

#### **13.3.1.1 Professional Ethics in the Accounting Business: Highlights on the Body of Licensed Accountants and Expert Accountants in Romania (CECCAR)**

As a rule, economic entities activating on the Romanian market monitor changes in their assets, liabilities, and equity with the help of licensed or expert accountants. Along with managers, they are accountable by law for the correct preparation of financial statements. In theory, managers should possess adequate financial and accounting knowledge in order to scrutinize professionals’ decisions regarding their

businesses. In practice, managers often overlook such recommendations and entrust the accuracy of financial statements to their employees for various reasons (e.g., lack of sufficient expertise, lack of time). Nevertheless, there are special public organisms that oversee accountants' expertise.

The activity of accounting professionals is regulated by the Body of Licensed Accountants and Expert Accountants in Romania (CECCAR), which was founded in 1921 through a royal decree. All individuals aiming to provide accounting services and be recognized as certified accounting professionals must become members of this Body, according to the Accountancy Law (Law no. 82/1991) and the Government Ordinance no. 65/1994 on the organization of the expert accountant and licensed accountant practice (republished). As stated by the Law no. 200/2004, CECCAR is the "competent authority" in Romania concerning international recognition of accountancy qualifications.

Having a history of almost a century, CECCAR is an independent, autonomous, non-profit, internationally recognized public interest organization, which has been advancing the precepts of professional accountancy in Romania. It became member of the International Federation of Accountants (IFAC) in 1996.

Similar to any other professional organization or respectable economic entity, CECCAR advocates the importance of respecting ethical standards by means of an ethics code. For that matter, it has adopted the IFAC Code of Ethics (2009 edition) under the name of "National Code of Ethics for Professional Accountants" (CECCAR 2011), with special amendments required by the Romanian legal framework. Besides an explanatory introduction highlighting these amendments, the document is structured into three parts dealing with: (A) the general application of the code; (B) professional accountants in public practice; (C) professional accountants in business. The first part introduces the fundamental principles of ethics in accountancy and indicates a conceptual framework to be applied for identifying and mitigating compliance threats. The second part addresses mainly professionals in public practice and lists various safeguards in tackling compliance threats. The third part features a similar content, this time addressed to professional accountants in business.

Therefore, the code sets rules and principles which have to be respected and applied by all members, either self-employed or regular professionals employed in accounting firms. Besides adhering to the CECCAR ethical precepts, members must possess eight qualities regarding their expertise, impartiality, and moral integrity (Fig. 13.4).

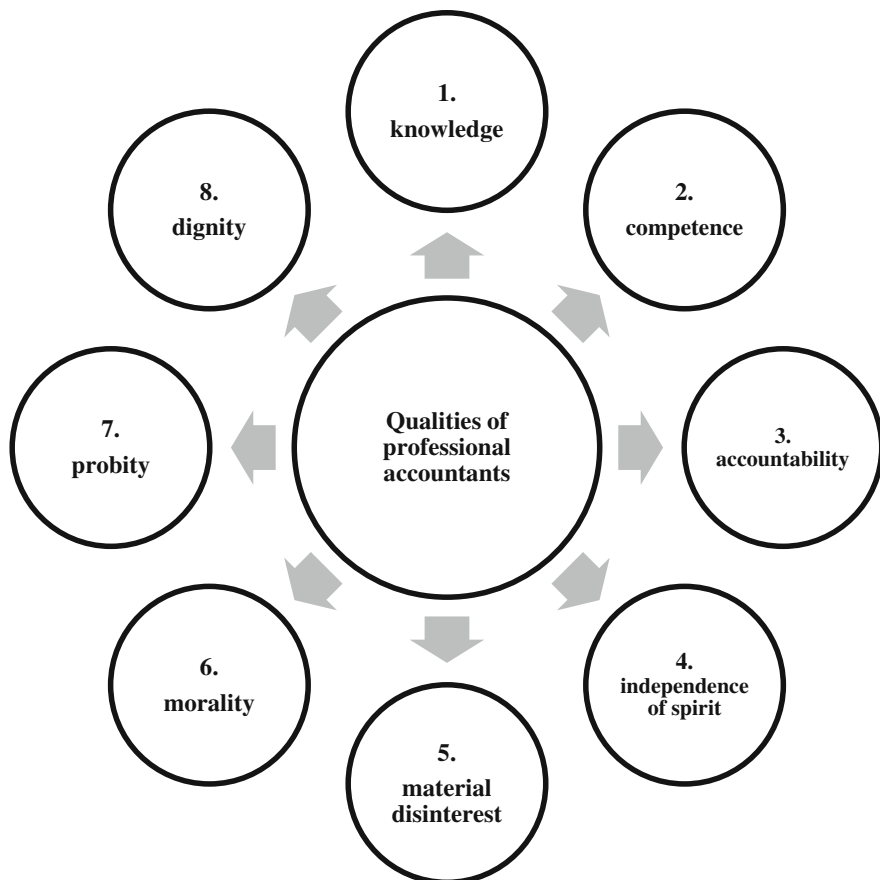
According to the code (CECCAR 2011), there are six fundamental principles that a professional accountant activating on the Romanian market should follow, as detailed in the subsequent paragraphs.

- **P1—Integrity:** Honesty, fair dealing, and truthfulness should prevail in every professional and business relation. In this line of thought, professional accountants should distance themselves from information that appears to be misleading or obscure.
- **P2—Objectivity:** Professional accountants should be impartial and should not let biases, interest conflicts, and third-party influences affect their judgment and

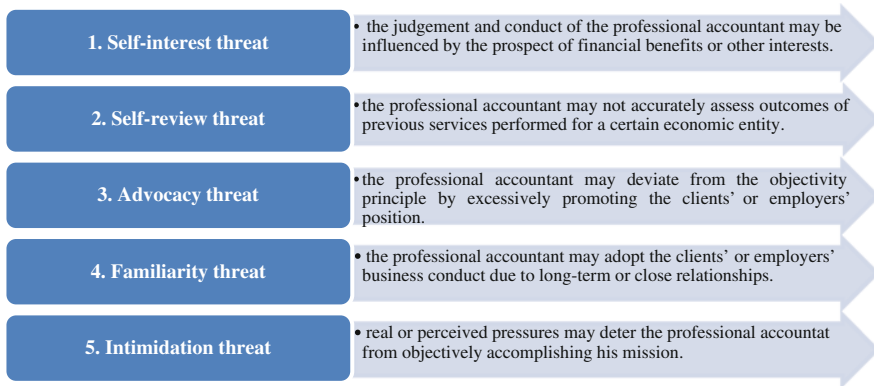


behavior. Therefore, they have to remain objective in all situations and decline to accept potential benefits (e.g., substantial gifts, preferential treatment).

- **P3—Professional competence and due care:** Professional accountants should possess solid accountancy knowledge and skills, updated with the latest developments in their field (practice, legislation, technical standards), and perform their activity with seriousness, attention, and meticulousness. Moreover, professional accountants should make sure that the people they coordinate while practicing are adequately prepared and supervised, thus mitigating accounting errors risk. In this way, employers and clients enjoy the benefits of competent professional service.
- **P4—Confidentiality:** It is mandatory for professional accountants to respect the confidentiality of information acquired from current or potential clients, while interacting with third parties in both social and business environments (e.g., kin,



**Fig. 13.4** Main qualities of professional accountants as CECCAR members. *Source* Adapted based on the “National Code of Ethics for Professional Accountants” (CECCAR 2011)



**Fig. 13.5** Main categories of threats regarding compliance with ethical principles. *Source* Adapted based on the “National Code of Ethics for Professional Accountants” (CECCAR 2011)

business partners). Hence, professionals must neither disclose confidential information to third parties (unless they are authorized or requested by the law), nor make use of it for personal or third-party advantages. The confidentiality clause is valid even after the ending of the contract. Nevertheless, there are specific situations when confidentiality breaches are accepted (e.g., disclosure authorized by the client and permitted by law, disclosure requested by law, disclosure as professional duty and permitted by law).

- **P5—Professional behavior:** Compliance with the legal and regulatory framework is mandatory for all accountants, who must not discredit their profession in both business and social environments. Professionals should adequately promote their accountancy knowledge and skills, without claiming a false expertise.
- **P6—Technical and professional standards:** Professional accountants should perform their activity pursuant to the fundamental technical and professional standards. The clients' or employers' requirements have to be followed as far as the principles of integrity and objectivity are respected. Moreover, professionals in this field are requested to adhere to the standards issued by organizations like the International Federation of Accountants, International Accounting Standards Board, or the Chamber of Financial Auditors of Romania.

According to the CECCAR code, the judgment and behavior of the professional accountant may be subject to various threats regarding compliance with ethical principles, as presented in Fig. 13.5.

Despite listing the major threat categories, the code also acknowledges the impossibility of indicating “ethical requirements applicable to all situations that the professional accountants may face.” Hence, on the basis that the code highlights basic precepts, accountants have to assess each situation through an ethical lens. They cannot be concerned exclusively with satisfying the needs of customers or employers above the ethical principles, but they have to act in the public’s interest.

### 13.3.1.2 Fundamental Principles of the Ethics Code in the Tax Administration

Previously we have argued that an ethical business behavior entails abiding by the letter and the spirit of the law, which in the tax system translates into paying the fair share of taxes. In the following section, we tackle the top-down perspective of the tax game and highlight the main ethical precepts that should be guiding Romanian fiscal civil servants in their interaction with taxpayers.

The Romanian tax administration comprises the employees activating within the Ministry of Public Finance and subordinated institutions, i.e., National Agency of Tax Administration (ANAF), National Forecast Commission, National Agency for Public Procurement. In order to augment taxpayer's trust in the tax administration and ultimately increase the level of tax compliance, all fiscal civil servants are called to make decisions based on an ethics code comprising fundamental principles and obligations (i.e., professional, ethical), available to the general public on the webpage of the National Agency for Tax Administration.

The set of principles numbers eight components addressing fundamental aspects like equality, transparency or confidentiality, as follows:

- **P1—Equality:** The principle is grounded in the Constitution of Romania, which guarantees citizens' equality before the law and public authorities, without discrimination and favoritism. According to it, taxpayers are entitled to be treated equally in terms of establishing taxes, filling tax reports, paying taxes due, and access to assistance departments within the tax administration.
- **P2—Nondiscrimination:** Deriving from the principle of equality, nondiscrimination asserts that all taxpayers should be approached in a standard manner and not be treated with inferiority compared to other taxpayers based on their social status, ethnicity, gender, convictions (political, philosophical, religious), disabilities.
- **P3—Access to public information:** Depending on taxpayers' needs and tax administration resources, taxpayers are entitled to be regularly informed by authorities concerning public and personal interest matters. A case in point, it is mandatory for public authorities and institutions to provide a written answer regarding a public interest inquiry within 10–30 days, according to the complexity and urgency of the inquiry.
- **P4—Free tax assistance for taxpayers:** According to the Romanian Constitution, the right of petitioning is free of charge. Therefore, taxpayers have the right of being assisted and informed by fiscal civil servants without paying any fee.
- **P5—Transparency:** The principle of transparency stands at the grounds of an efficient dialogue between taxpayers and authorities. Moreover, transparency may serve as tool for supervising authorities' actions.
- **P6—Adapting to taxpayers' requirements:** The tax authority should permanently adapt to taxpayers' needs in order to improve the public services of assistance and informing. Thus, front-office civil servants should properly understand fiscal inquiries and meet taxpayers' expectations when providing a solution.

- **P.7—Respect and consideration toward taxpayers:** Fiscal civil servants have to approach taxpayers with respect and deference. They have to use a polite language, promptly answer when inquired by taxpayers, and avoid conflicting situations.
- **P.8—Confidentiality:** All information provided by taxpayers are to be kept confidential and not to be disclosed to third parties, unless the taxpayer or the law allows it.

According to the code, fiscal civil servants responsible for directly interacting with taxpayers must adhere to a set of professional obligations which include ongoing improvement of the professional training and developing communication skills. First and foremost, civil servants should possess solid knowledge regarding the main categories of taxes and the latest changes in the tax law regarding tax forms, submission deadlines, payment deadlines, etc. To reach this goal, the tax authority should invest in training programs to ensure a high level of competence among its employees, for, as Benjamin Franklin stated, “an investment in knowledge pays the best interest.” Secondly, because interactions with taxpayers are based on communication, fiscal civil servants have to possess excellent communication skills for facilitating the dialogue. Namely, they should inquire taxpayers in order to properly categorize a fiscal issue and give adequate information based on this categorizing. The improvement of communication skills may also be achieved through training programs co-financed by the National Tax Authority, like the one implemented in Romania during the period 2011–2014. Entitled “Developing a viable partnership between the National Tax Agency and the direct beneficiaries of services provided by it—premise for making efficient the public revenue collection system (SMIS 31224),” the project developed *inter alia* standard procedures of communicating with taxpayers and trained a number of 188 fiscal civil servants at national level on communication techniques.

Besides the obligations imposed by the nature of the profession, fiscal civil servants who interact on a daily basis with taxpayers have to respect a manifold of ethical obligations ranging from appearance, attitude toward taxpayers or politeness degree, such as:

- disclosing their personal identification data (i.e., full name, position, workplace) to taxpayers by means of a visible badge or specific display signs (when activating in public relation offices);
- exhibiting a proper appearance, in accordance with their positions within the tax administration;
- performing their tasks in a disciplined manner, both in interactions with co-workers and taxpayers;
- displaying calm, politeness, respect, patience and a positive attitude when approaching taxpayers;
- employing a grammatically correct language and avoiding informal or highly specialized terminology, which could hinder the message conveyed to taxpayers;
- making all necessary efforts to assist taxpayers;
- addressing taxpayers’ inquiries in a correct and complete manner, while verifying the extent to which taxpayers understand the information they receive;
- maintaining confidentiality of all information provided by taxpayers;

- guiding taxpayers toward specialty departments within the tax administration, in order to obtain detailed information on specific tax issues;
- expressing gratitude to taxpayers for contacting the tax administration helpdesk and ensuring taxpayers of the tax administration's availability in assisting their needs;
- maintaining intact the authority of the tax administration.

### 13.3.1.3 Ethical Precepts in the Private Sector

Any free economic market is driven by competition. Namely, the majority of businessmen aim to occupy top positions in terms of market share and guide their actions by the words of the Scottish philosopher David Hume, who once stated: "And what is the greatest number? Number one." Yet, besides engendering economic development, competition can be rather fierce. Consequently, businessmen have to secure their upper hand against competitors (e.g., brand, logo, manufacturing techniques, product characteristics) and their integrity in the eyes of the clientele.

On the Romanian market, there are two public institutions overseeing business compliance with ethical principles related to competition and branding. The first institution is the Competition Council, which makes sure that both national and European Community legal frameworks regarding competition are respected by all players on the market and which aims to deter unethical business practices (e.g., attempted monopolization, cartel agreements, artificial increases in retail prices before VAT reductions). The second institution is the State Office for Inventions and Trademarks, which promotes industrial property and assists businesses in protecting the uniqueness of their brands and patents.

In addition to competition, another factor which determines the economic development of the market is the banking system. Being leading players on the monetary market, banks are responsible with permanently securing the capital flow in the economy by attracting deposits from the general population and facilitating the crediting process. In other words, banks are mainly interested in generating profit through credit risk management. Similar to any other business, the banking system is subjected to various risks types which can be diminished if the parties involved are trustful and trustworthy. In fact, trust is essential for both parties: on one hand, clients entrust banks their profits, wealth, life savings, or safety nets through deposits, under the promise of receiving back the entire amounts plus interest; on the other hand, banks entrust clients with large amounts of money through crediting based on a similar promise. Consequently, one way of fueling trust between business partners is by acting according to ethical precepts.

In Romania, players within the banking system are members of the Romanian Banking Association (ARB), a legal entity that established its ethics code in 2009 (available to the general public on the official webpage of the organization). This code regulates various types of interactions between credit institutions on one side and clients, authorities, employees, or other credit institutions, on the other side.

The principles stipulated in the banking ethics code are presented in the following paragraphs. Breaches of the ethics code by any member of the Romanian Banking Association are investigated and elucidated by the Honorary Jury of the organization:

- **BP1—Moral integrity:** Employees within the banking system are forbidden to use their position in order to directly/indirectly request or obtain benefits for themselves or third parties.
- **BP2—Impartiality and nondiscrimination:** Employees must display an objective and neutral conduct during their professional activity, without interests of any kind (e.g., political, economic, religious).
- **BP3—Professionalism and transparency:** Employees have to fulfill their work duties with responsibility, competence, efficiency, precisions, clarity, and dedication.
- **BP4—Compliance with the legislation in effect:** Employees have to follow both national laws regarding the banking system and internal regulations of credit institutions.
- **BP5—Confidentiality:** Employees have to maintain the confidentiality of the information related to the person, activity, wealth, business and personal relations with their clients. Consequently, professional secrecy regarding the information not meant for publication must be guarded throughout the employment period.
- **BP6—Prevention and fighting corruption, money laundering, and financing terrorism:** Such privative outcomes may be prevented by notifying and deterring any related banking transactions.
- **BP7—Exerting cautious actions while performing financial transactions:** Employees have to cautiously manage the financial resources of credit institutions and to adequately inform clients about all the characteristics of the banking products and services.
- **BP8—Social responsibility:** Credit institutions may get involved in solving various social problems and may support humanitarian initiatives.
- **BP9—Avoiding denigration:** Employees will perform their professional activities by following the ethical precepts of fair competition and protecting the interests of the parties involved.
- **BP10—Respecting all provisions of the banking ethics code:** All employees within the banking sector must adhere to the provisions of the ethics code by being accountable, understanding, and reporting any breach of the code.

### ***13.3.2 Empirical Findings Concerning Business Ethics on the Romanian Market***

#### **13.3.2.1 Academic Studies on Business Ethics**

Extensive studies on business ethics within the Romanian market are rather scarce, especially those involving economic entities. Nevertheless, the literature acknowl-

edges such inquiries, which will be presented in the following paragraphs. The reported results were obtained on both Romanian and foreign businesses activating in Romania.

As discussed before, Romania was among the 18 countries included in the research waves for the computation of the business ethics index (Tsalikis and Seaton 2008a) and it registered an overall score of 120.9, above the 100 benchmark score. Although reporting negative perceptions of business ethics was based on third-party opinions, participants from Romania generally indicated positive expectations regarding the future ethical behavior of businesses.

Su and Richelieu (1999) studied the attitudes toward bribery of 50 Western managers from small and medium enterprises operating on the Romanian market, coming from 14 countries (mostly European) and with major decision-making power in daily operations. The qualitative data were collected via a questionnaire, followed by a 45-min debriefing interview. In the questionnaire, participants had to evaluate first from their own perspective 25 business situations according to the degree of conformity with moral principles. Subsequently, they repeated the task by evaluating the situations from the perspective of their Romanian counterparts. According to the participants, five situations were labeled as ethical from both perspectives: firm competition; profit maximization; substantial salary differences between employees; dismissals; speculations in shortage periods, on exchange or interest rate variations. In addition, several situations were deemed unethical from Westerners' perspective and ethical in their counterparts' view, such as denouncing colleagues to superiors; borrowing company resources for personal use; favoritism or patronage; playing on ambiguity in unfavorable situations; bribery. Considering that the study was conducted on an unrepresentative sample and that the differences in business ethics were inferred using solely the opinion of Western managers, the results of the study should be carefully interpreted.

Al-Khatib et al. (2004: 85) studied the degree to which ethical ideologies like Relativism, Idealism, and Machiavellianism influence consumer ethics on a sample pool of 210 Romanian consumers via a self-administrated survey. Idealism is grounded on the "concern for others' welfare when evaluating alternatives" and assumes the existence of a "morally correct alternative that will not harm others." Contrariwise, Relativism assumes the rejection of universal laws and emphasizes situationally based decision-making. The authors presented participants with four scenarios of consumer ethics: "actively benefiting from an illegal activity"; "passively benefitting at the expense of others"; "actively benefitting from questionable action"; "no harm/no foul," comprising actions perceived as harmless, therefore acceptable. Hierarchical regressions indicated that consumers manifesting low levels of Machiavellianism and high levels of Idealism also expressed higher ethical concerns about passively benefitting at other's expense.

Stoian and Zaharia (2012) investigate the exogenous and endogenous channels that contribute to the development of corporate social responsibility (a fundamental concern for any ethical business) in former socialist economies. Starting from a survey on 194 Romanian employees activating full-time in domestic and multinational companies, the authors conclude that corporate social responsibility (CSR) emerges

from three channels, all highlighting employees' background. Namely, exogenous CSR is driven by employees' work experience in multinational companies, which are generally known for intensively promoting responsible behavior in the workplace and business environment. Endogenous CSR is driven by employees' experience within the socialist system, which seems to have triggered support toward the notion of responsibility. In addition, a hybrid CSR is believed to emerge as a result of two interactions: (1) work experience in multinational companies and CSR knowledge; (2) experience within the socialist system and CSR knowledge. In terms of age influence, results indicated that younger employees adhered less to the CSR principles. As expected, women managers declared to be more prone toward corporate social responsibility than men. The study of Stoian and Zaharia emphasizes the importance of raising CSR awareness within the business environment for the development of society as a whole.

Bageac et al. (2011) conducted a comparative study regarding business ethics on a sample pool of 200 management students from France and Romania, out of which 118 were Romanian. The authors were interested to identify possible country differences in attitudes toward three main business philosophies, i.e., Moral Objectivism, Social Darwinism, and Machiavellianism. According to the literature, businessmen who implement Moral Objectivism as a business philosophy act based on a rational self-interest and attain personal well-being only through a universally valid moral code. As an amoral philosophy, Social Darwinism states that, in a highly competitive economy, progress can be achieved only by pursuing the individual's self-interest. Machiavellianism is rooted in reality and distances itself from idealism. Also amoral, Machiavellianism focuses less on the means and more on the outcomes, therefore often being fueled by extensive corruption.

A multivariate analysis of variance (MANOVA) revealed significant effects of country and gender on the attitudes toward business philosophies. Namely, Romanian students agreed more with Machiavellianism, while French students preferred Moral Objectivism and Social Darwinism. Moreover, according to their results, participants' business philosophies were not influenced by religious practice. In term of gender, women seemed to favor Moral Objectivism more than Machiavellianism, as the former emphasizes the importance of groups and protection. Contrariwise, men showed more support for Machiavellian business practices, because it engenders competition.

Rountree et al. (2014) reported differences in cultural perceptions of ethical behavior based on results from a cross-cultural sample pool of business students residing in the US, Romania, Poland and Czech Republic. Following the same cross-cultural approach, Neal et al. (2015) studied attitudes toward corruption via the scenario technique on 300 business students from Lebanon, Romania, and the USA, out of which 100 were Romanian. Based on a scenario describing the process of starting a business on a foreign market, which involved corruption and bribery, participants were requested to analyze the ethics of 12 business decisions through four principled lenses: Universalist approach; "The system is at fault"; Ethical relativism; Consequentialist approach. A one-way analysis of variance (ANOVA) revealed that participants from countries registering higher levels of perceived corruption (i.e., Lebanon,



Romania) reported more lenient attitudes toward corrupt actions than those coming from a country with lower levels of perceived corruption (i.e., the USA).

### 13.3.2.2 Transparency International Romania (TI-RO) Study on Business Ethics

Besides academics, international organizations have also shown interest in studying conformity with business ethics precepts on the Romanian market. Transparency International Romania (2011) conducted a study on ethics and conformity management in August–November 2011. Through its research endeavor, the organization has brought to the attention of the general Romanian public a concept that has been characterizing the international business arena for almost 25 years and that enjoys various standards for building a corporate ethics infrastructure like the Red Book 2.0 (Mitchell et al. 2009) or the Burgundy Book (Mitchell and Switzer 2013).

The sample pool included 631 companies operating on the Romanian market, representing all eight development regions and 81 activity sectors, listed in national rankings according to their performance during 2008–2011. 56% of companies had their social headquarters located in Bucharest (i.e., the capital city), while the rest of companies were spread across all counties. The structure of the sample pool is presented in Table 13.2.

The selection of the companies was performed based on two criteria: (a) companies had to be active during 2009–2011; (b) information about financial performance (i.e., turnover) and number of employees had to be available for the period 2008–2010. In terms of turnover, 44% of the companies generated over 30 million Euros, 13% between 15 and 30 million Euros, 14% between 5 and 15 million Euros. In terms of workforce, the majority of companies had up to 500 employees, 13%

**Table 13.2** Structure of the company sample pool operating on the Romanian market

Type of company	Number of companies
Joint-stock company	316
Limited liability company	298
Company limited by shares	9
Subsidiary	3
Autonomous administration of state monopolies	2
Limited partnership company	1
Representation company	1
Professional limited liability company	1
Total	631

Source Adapted after Transparency International Romania (2011: 19)

activated with 500–1000 employees, 15% managed 1000–5000 employees, while 18% disclosed no information on this matter.

Being a complex and extensive study, the data collection process was conducted over four stages (Transparency International Romania 2011: 22). The *first stage* involved acquiring information on company identification data (i.e., legal form, headquarters, trade register number, unique registration code), financial performance and workforce using the National Tax Authority webpage and other webpages listing companies within the Romanian market.

The *second stage* focused on analyzing the official webpages of the sampled companies in order to identify (besides the abovementioned information) existing ethics codes, internal policies, and procedures regarding ethics and conformity, corporate social responsibility reports. According to Transparency International, 36% of the companies displayed their identification data on their webpages, as required by the law. Moreover, the webpages displayed a company code (i.e., ethics, conduct, or company values statement) in 18.5% of cases and a corporate social responsibility report in 11.57% of cases. Overall, the cosmetic market was the most performant, as more than 50% of companies displayed an ethics code. In terms of capital source, 86% of the companies with an ethics code entailed foreign capital investments. When taking into account financial performance and workforce, it was noticed that ethics codes were a common characteristic for companies generating turnovers above 30 million Euros or employing 100-500 people.

The *third stage* implied analyzing the websites of professional institutions or authorities in order to identify standards of ethics and conformity within various activity sectors.

Last but not least, the degree of ethics and conformity management (i.e., ethics codes, ethics trainings, ethics, and conformity audits) within the 631 companies was assessed directly via an online questionnaire containing 45 single answer and multiple-choice items. The subsequent paragraphs summarize some of the most interesting data revealed by the questionnaires:

- 60% of company representatives reported the *existence of a code* (i.e., ethics, conduct or deontological) within their companies. Taking into account the gap between the publicly displayed codes and the reported ones, TI-RO concluded that the company sample featured a low transparency level.
- According to 50% of participants, *developing an ethics code* took less than six months, while 16.7% indicated a period of more than two years. In addition, the development of the code had constituted the task of employees appointed by the management (37.5%), employees within the Human Resources Department (25%), Conformity Department (25%) or top management (12.5%).
- The majority of ethics codes were constantly *updated* (66.7%).
- In 66.7% of the cases, ethics codes contained *sanctions*. The most used ones were verbal or written warnings (26.3%), wage withholding or firing (21.1%), seeking damages in court (5.3%).

- 30% of companies declared to have an *Ethics and Conformity Department*. Among these, only 20% of the companies had allocated a budget to the department.
- 20% of participants were aware of the existence of an *Ethics Committee* or *Commission* in their company.
- 50% of companies financed *ethics trainings*. Such programs were organized when employing new people (37.5%), whenever needed (28.6%), annually (14.3%) or every six months (7.1%).
- 90% of companies were implementing *antidiscrimination policies*.
- 50% of companies employed standard forms of declaring interest conflicts for the entire staff.
- A whistleblowing policy had been implemented in 60% of companies. In most cases (35.7%), the notification would be received by the superior of the whistleblower.

## 13.4 Conclusions

The precepts of ethics, or the theory of right conduct, have been examined under various lenses including finance (OECD 2015; Song and Yarbrough 1978; Wenzel 2005), marketing (Sirgy and Lee 2007), management (Clegg and Rhodes 2006; Ghore 2015; Jackson and Artola 1997; Menzel 2015; Morgan 2011; Steinmann and Scherer 1998; Treviño and Weaver 2012), law (Hazard Jr. 1995; Yeoh 2010), education and research (Bowen 1992; Floyd et al. 2013; Rossouw and Stückelberger 2011), policy making (Steinberg and Austen 1990) or international business (Donaldson 1989; Pitta et al. 1999).

With every endeavor, more emphasis is placed on the importance and benefits of ethics precepts for society as a whole. Ethics establishes ground rules concerning interpersonal interactions and instructs people against harming others' well-being for personal gains. In a nutshell, ethics is an invaluable instrument that can educate individuals to perform their activities in the right way. For, as Nelson Mandela used to say, education "is the most powerful weapon which you can use to change the world."

In the first instance, the present book chapter tackles briefly general characteristics of business ethics and some of its key concepts. Thereby, the reader is gradually introduced to concepts like compliance with the letter and the spirit of the law, responsibility, trust, and trustworthiness. Business ethics is also discussed within the dynamics of the tax game between contributors and tax authorities, with the emphasis that solely tax compliance qualifies as an ethical behavior, in our view. Despite being legal, tax avoidance practices are not considered ethical, because they "deprive" state budgets of substantial tax revenues in favor of corporate taxpayers and to the detriment of regular citizens. In this particular setting, the literature reports that compliance decisions are shaped by individuals' tax ethics level. That is, tax evasion is less likely to emerge among taxpayers if moral aspects are taken into account.

The second part of the book chapter scrutinizes the characteristics of business ethics on the Romanian market, which has been regulating the activity of some professionals like accountants since 1921, with the official establishment of the Body of Licensed Accountants and Expert Accountants in Romania (CECCAR). Theoretical aspects regarding ethical precepts within the public and private sectors are considered, with special focus on the ethics codes of the accounting profession, Romanian tax administration, and the banking sector. A brief assessment of these codes reveals that precepts like confidentiality, integrity, transparency, nondiscrimination, and professionalism are valued across all three areas.

In addition, the chapter presents a brief literature review of the business ethics studies performed by academic researchers and international organizations on Romanian consumers, employees, students, and Western managers as well as economic entities activating in Romania. Among these, the study conducted by Transparency International Romania (TI-RO) in 2011 on 631 companies is the most noticeable. According to their results, businesses in Romania still have to make considerable efforts in the process of institutionalizing ethics through the development of budgeted Ethics and Conformity Departments and educating employees to act in the right way through regular ethics trainings.

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# Chapter 14

## Business Ethics: Theory and Practice in an Islamic Context



Siti Faridah Abdul Jabbar, Hasani Mohd Ali,  
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### 14.1 Introduction

In Islam, the dilemma whether an act is ethical or otherwise may be resolved by referring to the principles that are enunciated in the *Qur'an* and *Sunnah*, which are the primary sources of the *Shari'ah* (Islamic law). Islamic business ethics, therefore, is based on these two sources and provides an essential foundation in the making of ethical business decisions by Muslim individuals and *Shari'ah*-compliant corporations. With regard the *Qur'an*, it is the Holy Book which Muslims believe contains the divine words of God (*Allah*) that have been revealed through the Prophet Muhammad. Some of the verses in the *Qur'an* are clear, precise and not open to debates (*qat'i* and *muhkam*) while some are general or vague (*mutashabihat* or *dzanni*) in character so that man could interpret<sup>1</sup> and consequently apply them in various situations at all times. This is mentioned in the *Qur'an* itself: "It is He Who has sent down to you (Muhammad) the Book (*Qur'an*). In it are verses that are entirely clear, they are the foundations of the Book and those are the verses of *Al-Ahkam*, *Al-Fara'id* and *Al-Hudud*; and others not entirely clear ... And those who are firmly grounded

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<sup>1</sup>Interpretation of the *Qur'an* as well as the *Sunnah* is called *ijtihad*. Nonetheless, *ijtihad* is not based on mere speculative thought or ad hoc law finding. On the contrary it is arrived at through a well-defined methodology of legal reasoning and legal interpretation called *usul al-fiqh* (Islamic legal theory). *Ijtihad* comes in the form of *ijma'* and *qiyas*, which are the secondary sources of the *Shari'ah*. *Ijma'* refers to the consensus or unanimous agreement of all Islamic jurists of an age. *Qiyas* is obtained through the legal and philosophical method of analogy whereby a divine law revealed for a particular situation is applied to another where some common feature exists in both situations.

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Zakiah Muhammadiyah Mohamed—Condolences on the passing of Assoc. Prof. Dr. Zakiah Muhammadiyah Mohamed on April 7th, 2017.

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in knowledge say: “We believe in it; the whole of it [clear and unclear Verses] are from our Lord”...” (3:7). Meanwhile the *Sunnah* refers to the utterances, deeds and tacit approvals of the Prophet Muhammad, which are reported as *Hadith*. It is to be noted that the objectives of the *Shari’ah* pertain to not only this world but include the Hereafter. As such the *Shari’ah* safeguards, in the words of Imam Al-Ghazali, a prominent Muslim philosopher, human being’s “faith, life, intellect, posterity and wealth” (Saleh 1992) that encompass their welfare in this world and in the Afterlife.

Accordingly, this chapter continues with a discussion on the concept of being or life in Islam. This is followed by a discussion on business from the Islamic perspective before embarking on Islamic ethics and business. Next, this chapter deliberates how Islamic ethics guide the manner by which business disputes are to be resolved; presents a case study on Islamic business ethics; and ends with a concluding remark. As a whole, this chapter is pertinent in the light of not only the increased efforts to control, if not annihilate, the proliferation of fraud by businesses but also the rapid expansion of business globally. The increase in cross-border transactions particularly relating to Islamic finance requires individuals and corporations alike to have a deeper understanding of foreign cultures and values that would assist in the smooth running of the business transactions. This chapter would give an insight and provide a general guideline on Islamic ethics particularly for those who have to deal with ethical dilemmas in business.

## 14.2 Concept of Being/Life in Islam

In Islam, the sole purpose of life is to please God and this is achieved not only through the cardinal act of worshipping God but also through living one’s life in accordance with Islamic values and virtues in order to foster and maintain a harmonious relationship with other beings. Apart from performing ritual acts such as praying, fasting, paying *zakah*<sup>2</sup> and performing the pilgrimage, a Muslim is ordained to interact with other human beings, animals and the environment with compassion and respect, which leads to the attaining of maximum blessings of God (see Qur’an 7:56). A Muslim who religiously performs ritual activities as well as attends to the welfare of his family, neighbours, community and the environment is considered to have a well-balanced life and more highly regarded than one who merely spends his entire day worshipping God but is oblivious to the plight of those around him. The Prophet Muhammad said: “Whoever loves that he be granted more wealth and that his lease of life be prolonged then he should keep good relations with his kith and kin” (Hadith Bukhari). The basis for the foregoing Islamic teaching is ‘*tawhid*’, which means ‘unification’ or ‘asserting oneness’ (Philips 2005). What the word connotes is the belief in the oneness of God where man worship Him alone by obeying

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<sup>2</sup>*Zakah* or alms tax is an amount of money which is calculated using a specific formula. Muslim individuals and *Shari’ah*-compliant businesses that fulfil certain criteria of wealth are to pay *zakah* to the authority who will then distribute the money to the poor in the community.

Him and doing religious deeds sincerely for His sake only (see Qur'an, 39:11). In the words of Ghazali (2005) *tawhid* means "man's commitment to Allah, the focus of all his reverence and gratitude, the only source of value. What Allah desires of man becomes value for him, the end of human endeavour". *Tawhid* is the main reason why man fully obeys God even in the absence of other human beings or any codified laws because it gives him the sense that his conducts are observed by God at all times. In relation to this the Prophet Muhammad said: "Worship Allah as if you see Him. If you do not see Him, He sees you" (Hadith Bukhari and Muslim). *Tawhid* also instils in man the acknowledgment that everything in this world belongs to God and is merely on loan to him. Humans are trustees who are to utilise and enjoy the worldly bounties as directed by God because they will be questioned in the Hereafter and held accountable for all their actions (see Qur'an 36:65). Thus, every human activity including business is to be directed towards seeking God's pleasure and avoiding His displeasure.

### 14.3 Business and Islam

During the early years of Islam not only were there many successful businessmen especially among the companions of the Prophet Muhammad but the Prophet himself was once involved in business particularly when he was in charge of the trading of the estates of Saidatina Khadijah, who later became his wife (Yusof and Rahman 2010). The Prophet was, in fact, a respectable businessman and fondly called by others as '*al-Amin*' (the trustworthy) because of his well-known honest dealings in business. Business is, therefore, a recognised activity in Islam and known as *mu'amalat*. Nonetheless, the purpose of business is not profit maximisation but to secure a degree of material independence and self-sufficiency for the businessman concerned as well as to benefit the community at large from the generation of wealth, creation of jobs and discovery of innovations that stem from the business venture. In Islam, a Muslim is expected to be independent materially and should not beg from others. He is encouraged to find a legitimate occupation where earnings from the occupation would sustain himself and his family members with the latter being obligatory on him. It was narrated by Abu Hurairah that the Prophet Muhammad said: "The best alms is that which is given when one is rich, and a giving hand is better than a taking one, and you should start first to support your dependents" (Hadith Bukhari). Obviously one of the means by which such could be achieved is through business where one would become independent by not having to rely on others materially and in turn would result in honesty and bravery void of any undue influence in the performing of actions and making of decisions (Jabnoun 2012).

Furthermore, business activities such as trading may not only generate earnings for the trader but also provide the platform for the exchange of goods or obtaining of services that would fulfil various human needs. The latter, which is regarded as the act of helping one another, is a role of business that augurs well with what God says in the *Qur'an*: "And cooperate in righteousness and piety, but do not cooperate

in sin and aggression. And fear Allah, indeed, Allah is severe in penalty” (5:2). The philanthropic role of business, however, does not mean that Islam prohibits the making of profit and accumulation of wealth but such an endeavour should take into account the welfare of others and should not be achieved at their expense. This is because in Islam any economic activity is to bring about an equitable distribution of income and wealth so as to establish a just socio-economic order. The economic well-being of the community (*ummah*) should be taken into consideration in one’s effort to accumulate wealth since such an effort has religious and divine connotations to it. Thus, in Islam businesses are to be free from any kind of misdeed, abuse, manipulation and other forms of misconduct. Indeed, this is not an easy task because it is human nature to easily succumb to temptations and greediness particularly where businesses are first set up with maximising profits in mind. However, in Islam apart from *tawhid* where one is reminded that all his actions should be directed towards seeking God’s pleasure, there is another driving force that would help keep businesses free from any form of malpractice. The driving force is ‘*taqwa*’, which literally means to fear God. God says in the Qur’an: “O you who have believed, fear Allah as He should be feared and do not die except as Muslims [in submission to Him]” (3:102). *Taqwa*, thus, gives the determination to a Muslim to remain in the path that God recommends and to refrain from indulging in what God dislikes, disapproves or penalises (Yasin 1992). This is because the fear of invoking God’s wrath surpasses that of obtaining worldly gains, which are merely temporary. *Taqwa* would guide a Muslim to place his objectives and purposes only for God, which is aimed at getting His blessings by being closer to Him (*taqarrub*). Thus, businesses if run honestly would serve as one of the means by which to be closer to God and obtain His blessings. Running an honest business is considered part of the act of worship (*ibadah*) that would please God and accordingly bring successes not only in this world but also in the Hereafter.

#### 14.4 Islamic Ethics and Business

The importance of ethics in Islam can be seen in the saying of the Prophet Muhammad: “I was sent to accomplish excellent behaviour” (Hadith Muslim). Further in the Qur’an God says: “And indeed, you [Prophet Muhammad] are of a great moral character” (68:4). Ethics is referred to in Islam as ‘*akhlaq*’ albeit *akhlaq* has a broader and more comprehensive meaning and scope. *Akhlaq* encompasses everything that the *Qur’an* and *Sunnah* of the Prophet Muhammad prescribe for a Muslim. It is not limited to values and virtues affecting human interaction with one another but includes human interaction with animals, the environment and God. It applies not only in one’s personal life but public as well and covers activities in all areas of life such as social, business and politics. *Akhlaq* is intertwined with *taqwa* where the fear of God would guide a Muslim to always practice excellent behaviour and likewise the consistent practice of excellent behaviour would lead to the attainment of *taqwa*. Thus, *akhlaq* serves as a means to achieve the ultimate end of pleasing God and obtaining His blessings. To practice *akhlaq* in one’s daily life, one must

give a full endorsement to the *Qur'an* and *Sunnah*, which serve as the sources where the core principles of *akhlaq* are obtained. Some of the core principles are discussed hereinafter and they are *ikhlas*, *zuhud*, *tawakkal*, *amanah*, *siddiq* and *'adl*.

### 14.4.1 *Ikhlas*

With regard to *ikhlas*, it connotes a virtue where an individual's purpose and ultimate aim in doing something is only for the sake of God and not for material gains or personal rewards. Having said that, it is to be noted that there is nothing wrong with obtaining material rewards as a consequence of one's endeavour but the rewards are merely secondary with God's approval remains as the primary aim. In fact if one is *ikhlas*, all rewards either in this world or in the Hereafter will follow suit. God says: "But seek, through that which Allah has given you, the home of the Hereafter; and [yet], do not forget your share of the world. And do good as Allah has done good to you. And desire not corruption in the land. Indeed, Allah does not like corrupters" (Qur'an, 28:77). *Ikhlas* is absent if the ultimate intention of doing something is not for God such as placing one's self-interest in priority over God. Further, *ikhlas* would safeguard an individual from engaging in any misdeed or misconduct. To illustrate what *ikhlas* is, let's assume an individual runs a business with the aim of making a profit. This aim, however, is only secondary to him for his primary aim is to obtain God's blessings. Running a legitimate and honest business to make a profit so that one may sustain his livelihood and his family's and, therefore, would not beg from others is an act of worship that would please God. Since his primary aim is to obtain God's approval, he would refrain himself from engaging in dishonest conducts such as cheating although he would seemingly make more profit if he was to cheat. In the event he is blessed with a surplus of profit he would not hesitate to give alms to the poor and needy as instructed by God. There is, however, no element of *ikhlas* should he conduct his business with the sole aim of becoming rich and accumulating as much wealth as possible. In the latter scenario, he could be persuaded to engage in reprehensible conducts in his pursuit to accumulate unlimited wealth.

### 14.4.2 *Zuhud*

Another act of *akhlaq* is '*zuhud*' where one places this worldly life and all its attractions subservient to his quest in achieving God's blessings. Although he may enjoy life, the enjoyment would not distract him from his remembrance of God. In relation to this God says: "Beautified for people is the love of that which they desire—of women and sons, heaped-up sums of gold and silver, fine branded horses, and cattle and tilled land. That is the enjoyment of worldly life, but Allah has with Him the best return" (Qur'an, 3:14). It could be deduced from this *Qur'anic* verse that all the attractions in this worldly life such as wealth are from God and humans are

allowed to enjoy them. However, such worldly attractions are insignificant since they are merely temporary in nature as opposed to the eternal rewards in the Hereafter. Therefore, the rewards in this world are not an end in themselves that one would feel frustrated about in the event that one fails to acquire them or loses them. Accordingly, a business with the virtue of *zuhud* would not be engrossed in creating wealth for itself, which is merely temporary in nature, and ignore, for example, its social responsibility as ordained by God. In fact, its acquisition of wealth would be done in conformity with God's will and directive.

### 14.4.3 *Tawakkal*

Related to *zuhud* is '*tawakkal*', where one's hope for or expectation of success in any particular endeavour is placed within Allah's will. *Tawakkal* means as human, one could only plan and hope to achieve a certain goal but ultimately it is God who determines whether he would achieve the goal. In other words, humans are to put in their best efforts to achieve their goal but since whether or not they achieve the goal rests with God they would embrace with an open heart should failure be the outcome that God has willed for them. In relation to this God says: "... And whoever fears Allah, He will make for him a way out. And will provide for him from where he does not expect. And whoever relies upon Allah, then He is sufficient for him. Indeed, Allah will accomplish His purpose. Allah has already set for everything a [decreed] extent" (Qur'an, 65:2&3). Accordingly, businesses that are run with *tawakkal* would not, for example, adopt various unhealthy practices to outdo or outlive their competitors, which in the long run would cause unwanted animosity and rancour within the business community. Businesses that are run with *tawakkal* would put in their best efforts to achieve their goals, be void of any unhealthy practices, and thereafter submit to God's will for the resultant success or even failure. In the event of success, they would be grateful to God but should failure follow they would not easily lose hope.

### 14.4.4 *Amanah*

*Akhlaq* is also manifested through '*amanah*' which is literally translated as trust and connotes the principle of accountability to God. God says in the *Qur'an*: "O you who believe! Betray not Allah and His Messenger, nor betray knowingly your Amanat [the things entrusted to you]..." (Qur'an, 8:27). In Islam, all resources that are bestowed upon human are regarded as a trust from God and this includes business resources that must be deployed and channelled for the benefit of the deserving individual, society and ultimately God (Wafa et al. 2005). In other words, *amanah* entails the idea that all resources must be employed in such a way that they will not destroy or have a devastating effect on the society and the environment (see *Qur'an*, 55:5-9).

Thus, businesses that harm the environment, for example, have breached the trust that has been placed upon them by God. Similarly, a person who has been assigned with a responsibility such as in the form of work is to regard the work as an *amanah*. If he does not perform his job properly, he is considered as having breached the trust that has been placed upon him not only by his employer but God as well. In relation to this, the Prophet Muhammad said: “an office is a trust; it is a humiliation except for those who rise equal to the task and pay everyone his due” (Hadith Muslim). Clearly, commitment to work is a trust and a form of worship (*ibadah*) in Islam. Islam places a great emphasis on one’s duties, obligations and responsibilities to others so as to avoid conflicts and misconducts (Shanmugam and Perumal 2005).

#### 14.4.5 *Siddiq*

Another element of *akhlaq* is ‘*siddiq*’, which means truthfulness. *Siddiq* promotes honesty, which is the most important attribute in business from the Islamic viewpoint. This is evident where the Prophet Muhammad said: “An honest and trustworthy merchant will be with the martyrs on the Day of Resurrection” (Hadith Ibn Majah and Hakim).

The Prophet was similarly reported to have said: “An honest and trustworthy merchant will be with the prophets, the truthful and the martyrs” (Hadith Hakim and Tirmidhi). It is, thus, clear that in Islam an honest businessman is regarded as highly as a Prophet and this reflects the importance of honesty in business. Apart from the foregoing *Sunnah*, there are numerous other *Sunnah* of the Prophet Muhammad that illustrate the importance of utmost honesty between parties in business transactions. One of them is where the Prophet said: “it is not permitted for a Muslim to sell to his brother a sale in which there is a defect, unless he discloses it to him” (Hadith Ibn Majah and Ibn Hanbal). In another Hadith, it was reported that the Prophet thrust his hand into a heap of corn and when his fingers felt wet he asked the trader about it who replied that rain had fallen upon the corn. The Prophet subsequently said: “Why did you not then keep [the wet portion of] it above the dry corn, so that men may see it? He who deceives, is not one of us” (Hadith Muslim). It could be understood from the several above-mentioned *Sunnah* that a seller who is aware of any defect in the object of sale is required to inform the buyer about the defect although it is not enquired by the latter. Thus, the common law rules of *caveat emptor* and ‘mere silence is not fraud’ are incompatible with Islam since Islam demands all dealings to be carried out with absolute honesty (Jabbar 2012). Islam also detests the act of confusing the truth with falsehood where God says: “...mix not the truth with falsehood ...” (Qur’an, 2:42). In another *Sunnah*, the Prophet Muhammad said: “... If they were truthful and had given exact description, their transaction will be blessed; if they did not disclose the facts ... their transaction will be stripped of all blessing” (Hadith Bukhari). Accordingly, what could be further construed is that Islam places great importance to parity-of-information between transacting parties. The concealment of information and the giving or release of inaccurate information are prohibited and



abhorred. In fact, the informational disadvantaged party during the conclusion of the transaction is given the option to annul the transaction (Obaidullah 2001). Thus, the prohibition of insider dealing, for example, is compatible with Islam since the conduct frustrates the requirement for parity-of-information (Jabbar 2010).

#### 14.4.6 ‘*Adl*

*Akhlaq* is also portrayed through “*adl*” which means justice. Applying the principle of ‘*adl*’ to business, it means that there should not be any form of unfair trade practices, the taking of unfair advantage of another, unjust enrichment, manipulation or oppression. God says: “And eat up not one another’s property unjustly ...” (Qur’an, 2:188). Further, God says: “... eat of the good lawful things ... and commit no transgression or oppression therein ...” (Qur’an, 20:81). Meanwhile the Prophet Muhammad said: “Do not take advantage of others by leaving the marketplace to meet trade caravans and begin negotiating with them before others can do so and do not interfere in the transactions of others and do not conspire to raise prices, nor may a city-dweller take advantage of a bedouin and do not cause milk to collect in the udder of a she-goat by not milking it [thereby inflating its value to a potential buyer by misrepresenting the quantity of milk it normally yields]” (Hadith Bukhari and Muslim). It could be deduced from the *Qur’anic* verses as well as the *Sunnah* that Islam emphasises on justice in one’s dealing with another especially with regard to dealings in wealth. Islam gives significance to fair and equitable transactions so that no one suffers from any form of injustice or unjustifiable loss (Saleh 1992). Accordingly, preference shares that give its holders preferred rights (Alhabshi 1994) and insider dealing that gives an unfair advantage to the insider (Jabbar 2010), for example, are impermissible in Islam since they erode the elements of fairness and equity. Transactions that are unjust are liable for cancellation even after they have been concluded (Abdal’ati 1976; Ahmad 1999).

In short, Islamic ethics of *akhlaq* is highly valued since it has a spiritual backing. This is evident during the first few centuries of Islam where economic activities that were guided by *tawhid* and *taqwa* were imbued with morality and ethical behaviour. Adherence to the Islamic ethics of *akhlaq* created strong business institutions and a market economy that was founded on justice and fair competition. Muslim merchants even travelled to and welcomed in foreign lands and conducted successful trades in various countries (Ali and Al-Owaihian, 2008). Meanwhile in an empirical study conducted by Ali (1995), a management researcher, it was observed that “the internalisation of Islamic concepts strengthened certain qualities: honesty, trust, solidarity, loyalty and flexibility”. Even Ku’ng (2007), one of the world’s greatest Christian theologians, wrote in his book that Islam serves as a positive example because the teachings of the religion infuse spiritual values and ethics into the globalised economy and society.

## 14.5 Islamic Ethics and Business Dispute Resolution

The core principles of *akhlaq* not only provide the guidance as to how businesses are to be conducted but they also present the manner as to how disputes are to be resolved. Applying the Islamic ethics of *akhlaq*, dispute resolution efforts are not solely meant to resolve conflicts between conflicting parties but ultimately for the sake of God to obtain His blessings. God ordains that disputes are to be resolved in an amicable manner and with justice. God says in the *Qur'an*: “And if two parties (or groups) ... fall into a quarrel, then make peace between them both ... make reconciliation between them with justice and be equitable. Verily, Allah loves those who are fair (and just)” (49:9). Clearly, Islam strongly advocates for an amicable settlement in settling disputes that is based on an equitable, fair and just manner which result in justice and a win-win situation (Ali 1993). Such is considered the basic tenet of civil justice in Islam so that a balanced and just society comprising of balanced and just individuals is achieved (Rashid 2004). Although litigation (*qada*) as a form of dispute resolution is recognised in Islam, the *Qur'an* and *Sunnah* are replete with preferences for an amicable settlement. The Prophet Muhammad’s preference for an amicable settlement is evident where he immediately set out for a *sulh* (mediation) when there was an intra-tribe dispute among the tribe of Amr bin ‘Auf (see Hadith Bukhari).

After the death of the Prophet Muhammad, the Great Companions of the Prophet who were the Great Leaders of Muslims (*Amir al-Mu'mineen*)<sup>3</sup> continued to prefer amicable settlement of disputes. Caliph Umar al-Khattab, the second Great Leader, for example, emphasised that “disputes should be avoided and an amicable settlement ought to be brought about (by the authority), because the unmistakable or decisive judgment would give rise to rancours or malevolences (*al-dagha'in*) among people” (Sadiqi 2010). After more than 1400 years since the days of the Prophet Muhammad, Islamic amicable settlement of disputes continues to be practised by Muslims albeit it is not as widespread as it used to be. It is worth taking note again that in Islam dispute resolution is not merely an inter-human activity but it has a divine connotation as well where it is regarded as an act of worship to God. Those who uphold a just (*‘adl*), fair and amicable dispute settlement will be handsomely rewarded by God, if not in this world, in the Hereafter. God says: “There is no good in most of their secret talks save (in) him who orders ... conciliation between mankind; and he who does this, seeking the good Pleasure of Allah, We shall give him a great reward” (4:114).

In resolving disputes, guidance shall be sought from the *Qur'an* followed by the *Sunnah* and finally *ijtihad*, i.e. interpretation of the *Qur'an* and *Sunnah* (see footnote 1). This is evident when the Prophet Muhammad sent Mu'adh ibn Jabal to be the judge of the people of Yemen and the Prophet asked what Mu'adh would base his judicial decisions upon. Mu'adh replied that he would refer first to the *Qur'an* and then to the *Sunnah*, and if the answer to an issue could not be found in the two sources he

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<sup>3</sup>Amir al-Mu'mineen was the term used in early Muslim history for the leader of all the Muslims. This office later developed into the hereditary Caliph. The Caliphate ended with the demise of the Ottoman Empire. See Sadiqi (2010).

would then use *ijtihad* (Sadiqi 2010). Further in Islam, amicable dispute resolution is permissible in every dispute, matter and situation except in cases involving the Rights of God (*huquq al-Allah*), for example, *hudud* which involve crimes such as robbery (*hirabah*) and treason (*baghye*). In such cases, decisive judgments (*qada*) are mandatory since only God has the authority to decide on the judgment with the courts being only His proxy on earth (Sadiqi 2010). Another key principle of an Islamic dispute settlement is for the disputing parties to come to a consensus. The parties are to not only mutually agree on the issue(s) of concern but also mutually accept proposals to resolve those concerns. This is because an amicable settlement between parties that preserves good relationship and restores harmony is of paramount importance in Islam. At the same time, Islamic dispute settlement places significance on collective interests instead of merely individual interest (Hoyle 2009). It is, thus, the duty of the disputing parties as well as the third party intervener to maintain the ties of family, brotherhood and community in the settlement of the dispute.

To exemplify the use of Islamic amicable dispute resolution in business dealings, the work of Juliano (2005) is referred to. One of the cases reported by Juliano relates to the use of *sulh* (mediation) among the Muslim community in the USA. In this particular case, two Muslims in a dispute over a business deal asked an *Imam* (a Muslim community leader) to decide what each of them was entitled to with respect to the deal. Once they acquiesced to be bound by the *Imam*'s decision, he listened to their evidence and determined an equitable amount that each party should receive. However, before the signing of the final agreement the *Imam* reminded them that his decision was only as good as the evidence they had provided him and that if either of them had influenced him with false testimony God would know and they would be held accountable on the Day of Judgment. One party began to weep and said that he had provided inaccurate information, and that he was not entitled to a portion of the sum awarded by the *Imam*. The other party was moved by his honesty and told him that he could keep the amount as originally awarded.

Although the use of *sulh* in the foregoing example occurs in an informal setting, it does not mean that *sulh* could not be institutionalised to cater for more complex business dealings. *Sulh* may be institutionalised to expedite the settlement process and ensure the enforceability of the compromise agreed upon by the disputing parties (Oseni 2009). Further, *sulh* is not merely a legal instrument in lieu of litigation that is to be adopted in private conciliation among individuals or groups but it is also a procedural option to be resorted to by a judge within his courtroom (*qada*) or an arbitrator within his conference room (*tahkim*) as long as the subject matter relates to the rights of fellow human beings (*huquq al 'ibad*), namely private claims such as tort, family law, inheritance and property rights' claims (Sadiqi 2010).

Above all, the success of amicable dispute resolution hinges on two factors (Craig 2012). First, there must be a true reconciliation which is beyond mere obedience. True reconciliation is achievable when the duty to reconcile is connected to *tawhid*. Second, dispute resolution must be consistent with the body of law constituting the *Shari'ah*. In other words, it is imperative that a dispute resolution mechanism adopts the Islamic ethics of *akhlaq* for the resulting decision to be accepted by all the parties. The importance of *akhlaq* in dispute resolution lies in the fact that it provides legiti-

macy to the consensus that has been derived from the dispute resolution process, thus deterring the parties from subsequently challenging the decision in the court of law.

## 14.6 Case Study on Islamic Ethics in a Business Organisation

The process of promoting ethical behaviour in Islamic entities is similar to that in secular ones. A major difference, however, relates to the focus in promoting Islamic values to employees. This is exemplified in the ensuing discussion of a case study on ethics in an Islamic organisation. The case illustrates how several core principles of *akhlaq* particularly *amanah* and '*adl*' are implemented and practiced in the organisation. It is to be noted that this case study is interpretive in nature in that it is premised on the interpretation of the authors.

The organisation in question is involved in the collection of *zakah* from Muslims in a particular state in Malaysia. It was previously a government agency that had been privatised in 1991 as a private limited company. One of the purposes of the privatisation effort is to break away from the red tape and bureaucracy of a government agency.

### 14.6.1 *Tone at the Top*

It is a well-known fact that the tone at the top would establish the ethical climate of an organisation. Since the organisation in this case study was then new, its first director had the opportunity to establish the right ethical tone at the top and set an example to all the employees. The first director is a strict person who pays particular attention to punctuality. All employees must be on time regardless of their position in the company. 'Leading by example' is one employee's description of the director. Further, no one would have the audacity to come to a meeting unprepared. Previously, customers complained that the employees were never in the office and that there was no one to attend to them when they went for enquiries. All these complaint, however, are minimised in the new company under the director's leadership where customers, who are the *zakah* payers, are now no longer left unattended. Indeed, the employees learn about work ethics from the director.

Strict adherence to deadline is another key management philosophy of this then young company. Targets are fixed with each personnel being given the opportunity to set his own target. All employees must have a weekly activity log that specifies their tasks for the week. Employees are also encouraged to seek knowledge to keep abreast with the latest development in economy and other matters. This is in line with what the Prophet Muhammad said: "Knowledge or wisdom is the lost treasure of a Muslim; wherever and whenever he finds it he must take it" (Hadith Tirmidhi and Ibn Majah).

### **14.6.2 Amanah in Practice**

Another important element that is stressed by the management is secrecy. All employees are constantly reminded to not divulge their clients' information to others. They have a motto of "keeping secret is an *amanah*". Employees are constantly tested by top management with simple questions to see whether they would reveal such information. They are also asked to divulge confidential information to other employees to see whether they would do so.

Further, the employees are constantly reminded that they are cheating God if they do not do their job properly. These constant reminders are done during meetings or through morning email circulation with verses of the Holy *Qur'an* attached. When the company moves to a new building, a proper praying facility, pantry and canteen are put in place. This is to encourage the employees to keep their activities within the confines of the office and spend less time outside so as to be more productive during work hours.

### **14.6.3 'Adl or Justice**

Any unethical behaviour would be investigated by the company's disciplinary committee which comprises of three individuals. The accused employee would be given ample opportunity to defend himself during an internal hearing. Evidence would be produced by both parties before the committee. Should the employee is found guilty he would normally be asked to resign without being fired. This is to ensure that the employee would have the opportunity to repent and find work elsewhere as well as to ensure that his family would not be shamed.

### **14.6.4 External Control Measures**

Control measures are also instituted in the company to prevent unethical conduct among employees. Among the control measures are the use of closed circuit television (CCTV) and log in/out system to monitor attendance. Other measures include the use of source documents and activity checklist as evidence for activities. The filing of collection that has been made is updated using new software to document *zakah* payments. This helps the organisation to be more efficient in record keeping.

### 14.6.5 Promoting Akhlaq or Ethical Conduct

Apart from the deterrent measures discussed in the foregoing, the company also uses proactive measures to encourage ethical behaviour. Among them are motivation sessions which are carried out every Friday evening, intellectual discourse for three or four times a year, recital of prayers every morning and attractive medical benefit to employees. Even the family members of the employees are included in some of the activities. Most of these measures are aimed at creating a sense of belonging among the employees. The employees are also reminded of their obligation to the Almighty through the call for prayers or ‘*adzan*’.

What may be surmised from the case study is that the management and employees of the organisation do not merely regard work as a source of sustenance but a means to please God as well. Therefore, punctuality, honesty, commitment to work and upholding justice are some of the Islamic ethics of *akhlaq* that are imbued within the organisation. Further, remembrance of God is not neglected amidst the hectic running of the organisation’s business.

## 14.7 Conclusion

Islam is not merely a religion but a way of life. The *Qur’an* and *Sunnah*, which are the two primary sources of the *Shari’ah*, contain teachings that encompass every aspect of human life including business. Business is encouraged in Islam provided that the Islamic ethics of *akhlaq* is strictly observed to ensure that the returns from business are clean, pure, free from dishonesty and misconducts, and ultimately receive God’s blessings. The core principles of *akhlaq*, which include *ikhlas*, *zuhud*, *tawakkal*, *amanah*, *siddiq* and ‘*adl*’, guide businesses to balance the pursuit of obtaining wealth with spiritual, moral and ethical considerations where the ultimate aim is to please God. While the accumulation of wealth is not prohibited and in fact encouraged, it is sinful to do so at the expense of other beings and the environment. An injustice has been done to the sanctity of man if wealth is unjustly acquired. This is because wealth is a trust from God which is to be utilised for the good of mankind particularly to alleviate the hardship of the poor. Indeed, Islamic ethics of *akhlaq* would help minimise, if not eliminate, unfair and evil practices in business activities. Should there be disputes in business that are caused by human failure the Islamic ethics of *akhlaq* continues to provide guidance as to how the disputes are to be resolved so that the initial animosity between the conflicting parties not only comes to an end but is settled in an amicable manner. In conclusion, Islamic ethics share many common grounds with temporal ethics with regard to values such as honesty, transparency and justice. However, Islamic ethics has an additional dimension since it is given a spiritual backing where businesses are regulated with faith and inner belief that would bring man closer to God. Nonetheless, the challenge remains in that the increasingly

materialistic world that we live in is luring the less strong-willed among us farther from fully embracing and applying the Islamic teachings in daily life.

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# Chapter 15

## Securities Market in India: Regulation of Undesirable Practices by the Securities and Exchange Board of India



Harpreet Kaur

### 15.1 Introduction

In India, raising of capital from the public comes under the purview of the Companies Act, 2013, the Securities Contracts Regulation Act (SCRA), 1956, and the Securities and Exchange Board of India Act (SEBI), 1992. The Companies Act provides for the principles relating to issue of prospectus, its content, allotment of securities and acceptance of deposits by the companies. It also contains penalty provisions for misrepresentations, etc., in prospectus or offer documents. By an amendment of the repealed Companies Act, 1956, in the year 2000, the power relating to issue and transfer of securities for public companies was vested in Securities and Exchange Board of India (SEBI). Similarly, under the new Companies Act, 2013, power is given to SEBI by s. 24. Since its establishment as a securities market regulator, SEBI has been regulating the securities market which is said to be not yet fully developed in India.

In order to regulate the securities market, SEBI has formulated regulations for almost all aspects of the securities market. It has developed regulations for issue of capital through shares and debt securities, issue of securitized debt instruments, prohibition of insider trading and fraudulent and unfair trade practices in securities market, delisting of securities and takeover and acquisition of securities, etc. It has been regularly amending the regulations in order to meet changing needs of market, but the challenges are many for SEBI as new issues keep cropping before it.

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## 15.2 Trends in Primary Market<sup>1</sup>

If one looks at trends in equity and debt issues in primary market in India, the cumulative amount raised was Rs. 48,324 crore in the financial year 2016–2017 through 80 issues in comparison with INR 22,491 crore raised through 63 issues during the corresponding period in 2015–2016. In May 2017, INR 7298.04 crore was mobilized through five issues of Qualified Institutional Placement compared to INR 5206.65 crore was mobilized through five QIP issues in the previous month. There were 48 preferential allotments amounting to INR 2377 crore during May 2017, compared to 41 preferential allotments amounting to INR 1835 crore listed during April 2017. During May 2017, an amount of INR 33,389 crore was raised through private placement of 301 issues in the corporate bond market. In May 2017, the total amount mobilized through public issues and private placement of both debt and equity combined stood at INR 44,544 crore as compared to INR 74,060 crore in April 2017.

During the current year, in the month of May, INR 1480 crore was mobilized in the primary market through seven public issues. All public issues were through equity and IPOs. During this month, no debt or rights issue was made. However, in the month of April in the current year, Rs. 3200 crore were mobilized through ten issues. In 2016–17, ten public issues of equity and two public issues of debt securities were made in comparison with corresponding period of 2017–18 in which public issues of equity and one of debt have been made (Table 15.1).<sup>2</sup>

The above table indicates very clearly that the private placement of debt securities is the preferred method of raising funds in India. In equity issues, private placement of securities is preferred over public issues. The total mobilization of resource is observed to be gradually increasing from 2010–11 to 2016–17 except in 2013–14 where it was comparatively less than 2012–13.

The primary capital market faced a slowdown due to economic slowdown, policies and their implementations. In fiscal year 2013, only one noteworthy initial public offer (IPO) raised Rs. 919 crore, which was the lowest amount raised so far. It is important to note here that although SEBI had approved public issues worth over Rs. 6000 crore, they were not issued because the market sentiments were not found to be in favour of investments through public issues (Haldea 2014). Even in public sector undertakings, last IPO was of NBCC in 2012. The Government wanted to revive the primary market by offering discounted IPOs in order to attract retail investors (Deepshikha 2014). However, the market improved gradually since the beginning of 2015<sup>3</sup> and in 2016, the primary market witnessed 83 initial public offerings which raised 3.8 billion US dollars. This improvement in performance is considered to be

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<sup>1</sup>SEBI Bulletin, Vol 14, Number 12, December 2016, Exhibit 1.

<sup>2</sup>Data is till the end of May of the respective years; SEBI Bulletin, Vol 15, Number 6, June 2017.

<sup>3</sup>Why 2016 is the year of IPOs, Swaraj Singh Dhanjal and Ami Shah available at <http://www.livemint.com/Money/hSfMTxYufKS6FqhCo1XNDI/Why-2016-is-the-year-of-IPOs.html>.

**Table 15.1** Total resources mobilized by corporate sector in India (amount in INR crore)\*

Month/year	Equity issues**			Debt issues			Total resource mobilization (4+7)
	Public	Private placement	Total (2+3)	Public	Private placement	Total (5+6)	
1	2	3	4	5	6	7	8
2010–11	58,157	56,308	1,14,466	9451	2,18,785	2,28,236	3,42,702
2011–12	12,857	27,871	40,729	35,586	2,61,283	2,96,868	3,37,597
2012–13	15,473	62,935	78,408	16,982	3,61,462	3,78,444	4,56,852
2013–14	13,269	60,125	73,394	42,382	2,76,054	3,18,436	3,91,830
2014–15	9789	57,362	67,151	9413	4,04,136	4,13,492	4,80,643
2015–16	25,077	65,102	90,179	34,112	4,58,073	4,92,185	5,82,364
2016–17	32,517	52,614	85,132	29,363	6,40,715	6,70,077	7,55,209

Data compiled from SEBI Bulletins available on [www.sebi.gov.in](http://www.sebi.gov.in)

\* 1 crore = 10 million

\*\* In the given table, private placement of equity includes amounts raised through preferential allotments, QIP and Institutional Placement Programme (IPP), whereas public equity issue includes initial public offer (IPO), further or follow on public offer (FPO) and rights issues of equity shares

through regulatory reforms and increased investor confidence.<sup>4</sup> As per annual report of SEBI, majority of the public issues received good response from foreign portfolio investors and other institutional investors along with retail investors.<sup>5</sup>

### 15.3 Public Offers

Most important issue that SEBI is dealing has been that of public offers by companies for raising funds which is either initial public offer or further issue of capital. In many such public issues, money raised through them is either misused by promoters of companies or due diligence is not performed by the merchant bankers or bankers conspire with promoters or fictitious applications for shares allotment through fictitious demat accounts are made or artificial demand for shares is created to have price hike through share brokers. Besides this, unlisted companies use manipulative devices to raise public funds through means of private placement of securities. During 2003–2005, twenty-one initial public offers were made in which

<sup>4</sup>Eighty-three IPOs hit Indian market, raised \$3.8 bn in 2016: EY published in the Business Line available at <http://www.thehindubusinessline.com/markets/83-ipos-hit-indian-market-raised-38-bn-in-2016-ey/article9446077.ece>.

<sup>5</sup>SEBI Annual Report 2016–17, page 81, available on SEBI website.

shares were not allotted to many.<sup>6</sup> These offers were rigged, and fraudsters involved gained Rs. 95.7 crore. Companies, namely NTPC, IDFC, TCS, JET AIRWAYS, YES BANK, Suzlon Energy and Shoppers Stop, offered these public issues. Fictitious demat accounts were opened, and shares were allotted to applicants through these demat accounts. The SEBI (Issue of Capital and Disclosures Requirements) regulations, 2009, deal with disclosures required to be made by the company in its offer document for information of investing public, appointment of merchant bankers and due diligence process to be carried out by them before public issue, minimum promoters' contribution in a public issue, determination of prices of shares before offering them to public, etc. In the last few years, SEBI restrained many promoters from siphoning off the funds raised through public issues for purposes other than those for which funds were raised. It is to be noted here that such funds can be used only for the purposes for which they were raised as is given by the companies in the prospectus. SEBI banned three bankers including PNB's merchant banking arm and seven listed companies for IPO violations.<sup>7</sup> These companies included Bhartiya Global Infomedia, Taksheel Solutions, Onelife Capital Advisors, Brook Labs and PG Electroplast. These companies and their promoters were accused of misusing IPO proceeds, performing poor due diligence process, aiding promoters to raise up prices of securities on the day of listing. They had made inaccurate statements in the prospectus and then siphoned off part of the proceeds to certain stock market operators. Shares of Taksheel Solutions were issued at Rs. 150/- per share, touched a high of Rs. 185/- per share and then fell to Rs. 38/- per share only. This high price could be attained only through creating false demand for the securities and is possible only through intermediaries involved in the process. PG Electroplast diverted a large portion of its public issue proceeds for operations in equity markets, questionable land deals and raw material purchases through the means of inter-corporate deposits (Dhirendra 2012). In the case of Onelife Capital Advisors, managing director and compliance officer of Atherstone Capital Markets was barred from being involved in any fund-raising activity.<sup>8</sup> These companies were barred from accessing securities markets, and merchant bankers have been restrained from taking further business. In order to restrict such manipulations, SEBI had decided to further tighten disclosure

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<sup>6</sup>Report of the Committee on reallocation of shares in the matter of IPO irregularities, [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1289366396898.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1289366396898.pdf). The committee identified 12.75 lakh persons as eligible investors for distribution of disgorged money due to no allocation of shares to them. Rs. 23.28 crore to 12.75 lakh investors was allocated in April 2010, out of which 7.99 lakh investors were paid the full eligible amounts. SEBI in second tranche distributed funds to those investors to whom partial amount was paid earlier and are entitled to receive additional amounts. SEBI is continuing its recovery process by identifying assets of the defaulters for recovering and distributing the same to the remaining investors. IPO irregularities: SEBI to refund disgorged funds to investors, Dec 17, 2015, available at <https://economictimes.indiatimes.com/markets/stocks/policy/ipo-irregularities-sebi-to-refund-disgorged-funds-to-investors/articleshow/50222034.cms>. The scam that changed India's primary market, Sundaresha Subramanian, Aug 2, 2016, available at [http://www.business-standard.com/article/markets/the-scam-that-changed-india-s-primary-market-116080101718\\_1.html](http://www.business-standard.com/article/markets/the-scam-that-changed-india-s-primary-market-116080101718_1.html).

<sup>7</sup>SEBI bans 3 bankers, 7 Cos for IPO violations, The Economic Times, Dec. 29, 2011.

<sup>8</sup>Diversion of Initial Public Offer money, The Times of India, Dec. 29, 2011.

norms.<sup>9</sup> All listed companies have to make disclosures as per listing agreements under SCRA, 1956, which are mostly of generic nature. Clause 36 of the listing agreement requires basic information on financial results and shareholding pattern. Six categories of price sensitive information are required to be disclosed by the listed companies or those who intend to list their securities. Key business events like announcement of periodic sale figures and performance matrices were not required to be disclosed. Such figures are very important in consumer-focused industries like auto, cement, real estate and aviation. It was seen that companies preferred to publish such information first through media and later on inform respective stock exchanges. In order to improve the situation, SEBI has now expanded the list of mandatory disclosures. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, now provide for principles governing disclosures and obligations of listed entities.

Fifteen companies were issued notices by stock exchanges on the ground that key developments were published in media but were not reported to stock exchanges. SEBI questioned about two hundred companies for sudden changes in share prices and trading volumes. Stock exchanges had to refer these inquiries to SEBI after clarifications were received so that necessary actions can be taken and further changes can be brought about in relevant regulations. SEBI held that all IPO disclosures are legally binding on companies. A prospectus is a document issued by the public company for raising public finance. A company issuing a prospectus is bound to make disclosures as per the requirement of the Companies Act and SEBI and is mandated to abide by the disclosures made by it. All disclosures whether they fall under mandatory or optional category, if the company has stated them in the prospectus, they have to be followed by the company. A company cannot be exempted on the ground that a non-mandatory fact was stated inadvertently.<sup>10</sup>

In order to control promoters and safeguard investors' interest in public issue, SEBI introduced concept of minimum promoters' contribution in SEBI (Issue of Capital and Disclosures) Regulations, 2009. Every promoter of a company coming up with a public issue has to contribute minimum twenty per cent of either post-issue capital or pre-issue capital which is subject to lock-in period of three years. Regulations also provide the types of securities that are not eligible for such contribution.

Unlisted companies often raise public finance through disguised private placement and manipulate provisions of both SEBI and the Companies Act. Glaring example is that of Sahara group companies. The so-called private placement by two companies of Sahara group was declared to be public issue by unlisted companies, and they have been ordered to refund the money of investors. The companies had collected around Rs. 25,000 crore through offer of optionally fully convertible debentures from more than 3 crore investors. It is to be noted here that private placement of securities can be made to not more than 49 persons as per SEBI (ICDR) Regulations, 2009. SEBI had a tough fight in order to ensure that investors' money gets refunded as

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<sup>9</sup>SEBI to tighten information disclosure norms, The Times of India, Feb. 14, 2012.

<sup>10</sup>All IPO disclosures are legally binding on companies: SEBI, [www.business-standard.com/article](http://www.business-standard.com/article), visited on Feb. 27, 2013.

it had no power to attach and sell properties of defaulter companies for refunding the proceeds of sale to investors. However, the Securities Laws (Amendment) Act, 2014, conferred not only the power for attachment of properties but also of search and seizure, arrest and detention of defaulters and pass disgorgement directions to recover the wrongful gains made in contravention of laws.

SEBI had mandated in 2011 that in all listed public companies, promoters' shareholding should be brought down to seventy-five per cent by the year 2013. This is maximum permissible non-public shareholding. In order to help promoters' certain options were given by SEBI like promoters were given facility of single window for selling their shares by auction in addition to already available methods of reducing shareholding by means of offer for sale, institutional private placements and further or follow on public offer (Arun 2011). SEBI again facilitated this by two other options, namely rights issue and bonus issue for reducing shareholding (Gupta 2012). Even then there were many promoters who were not able to reduce their shareholdings. An example can be taken of a company whose promoter was required to reduce his shareholding. At first, he came up with offer for sale and then he offered for delisting of securities. SEBI restrained the delisting offer as delisting increases the promoters' shareholding. However, there was a settlement to the effect that promoters would reduce their shareholding.<sup>11</sup>

## 15.4 Relaxations for Initial Public Offers

SEBI had considered allowing for a minimum dilution to the public of a 25% stake or Rs. 400 crore, whichever was lower. With this change, the companies with a market cap in excess of Rs. 1600 crore could limit their public issue to Rs. 400 crore. Earlier, they were mandated for 25% limit of public shareholding. A three-year time period from the date of listing was given to companies to achieve minimum public shareholding. It also considered raising mandatory public shareholding in public sector undertakings to 25 from 10%. During that period, it increased allocations to anchor investors to 60% from current 30%.<sup>12</sup> Relaxation was also offered to existing shareholders to participate in offer for sale in an initial public offer who were allotted bonus shares in last year subject to the condition that bonus shares were issued to them from the free reserves of the last financial year of the company (Ramesh 2014).

SEBI is trying to make it easy to raise money through IPOs while protecting interest of retail shareholders at the same time. It is increasing the number of disclosures that a company will have to make including the price discovery. It worked on the lines of establishing direct contact with the promoters of companies rather than through merchant bankers. Although all filings will have to be through merchant

<sup>11</sup> SEBI allows Fresenius Kabi Oncology to delist shares, [www.moneycontro.com/india/newsarticle](http://www.moneycontro.com/india/newsarticle), visited on Aug 22, 2013.

<sup>12</sup> Livemint, <http://www.livemint.com/Money/I9cDrBhsXxNyE204aJdLIK/Sebi-says-listed-state-firms-to-have-25-public-holding-in-t.html>.

bankers, the company can also contact the regulator. It started considering e-IPO option, and now this option is available for companies which want to raise IPOs. It also proposed to offer optionally fully convertible debentures in place of safety net mechanism.<sup>13</sup> Under safety net arrangement, an issuer may provide for an offer to purchase up to a maximum of one thousand specified securities per original resident retail individual allottee at the issue price within a period of six months from the last date of dispatch of security certificates or credit of demat account. Provision of safety net arrangement is optional for the issuer. SEBI had proposed that it should be made compulsory for the issuer but so far it has not been approved. It also considered making ASBA mandatory for all IPOs to prevent pressure on the fund payment and to provide benefits of interest earnings to the applicants. Under e-IPO, ASBA is compulsory for all categories of investors who apply for securities.<sup>14</sup>

## 15.5 Share Sale Deals

There were some suspicious share deals in which about Rs. 5 lakh crore was transferred as about reportedly 26,000 unlisted companies belonging to medium- to big-sized corporate houses transferred funds by using equity and preference shares at high premiums during last six years. As per the estimation of Income Tax Authorities, around 25% of such deals were probably not genuine. For example, sale of equity shares with face value of Rs. 1 and Rs. 10 at a premium of Rs. 5,00,000 and Rs. 49,00,000, respectively. Many share sales defied logic where three shares with face value of Rs. 10 each were offered at a premium of more than Rs. 100 crore per share. The reasons, which can be put behind such deals, may include efforts to keep the authorized capital low by issuing few shares at high premium in order to reduce payment to registrar of companies and use of their unlisted companies by big corporate houses to generate cash or convert unexplained cash into income. Section 68 of the Income Tax Act is invoked where the share premium charged is in excess of intrinsic valuation and the assessee is unable to explain the source of the credit and its nature (Ghosh 2014).

## 15.6 Insider Trading

SEBI also seeks to prevent insider trading through its SEBI (Prohibition of Insider Trading Regulations), 2015. It has replaced Insider Trading Regulations of 1992

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<sup>13</sup>SEBI may ask companies to make greater disclosures in IPOs, The Hindu, Jan 15, 2014, <http://www.thehindu.com/business/Industry/sebi-may-ask-companies-to-make-greater-disclosures-in-ipos/article5578668.ece>.

<sup>14</sup>SEBI's new e-IPO rules allow companies to list in 6 days, Livemint, Jun 24, 2015, <http://www.livemint.com/Money/H2mYgNLAIUMEcojoI5X9QJ/Sebi-decides-to-shorten-listing-period-after-IPO-from-12-day.html>.

after incorporating many changes in order to face new challenges imposed through such insider trading. New regulations enlarged the scope of definition of unpublished price sensitive information and connected persons. Insiders are not allowed to trade on unpublished price sensitive information (UPSI). Any information, relating to a company or its securities, which is not generally available but upon becoming available may materially affect the price of securities, will be unpublished price sensitive information. This includes information about financial results, dividends, change in capital structure, mergers, demergers, acquisitions, delistings, disposals and expansion of business and such other transactions, changes in key managerial personnel and material events in accordance with the listing agreement but is not limited to only such information. An interesting process of submitting trading plans to compliance officers of companies has been provided in regulations. Any insider who is perpetually in possession of UPSI is entitled to formulate a trading plan for a period not less than twelve months and seek approval of compliance officer. This plan should be detailed plan indicating the value of trades, number of securities to be traded, nature of trade and intervals at which such trade would be carried out. Once it is approved and publicly disclosed, he may carry out trading as per approved plan. However, such trading will not commence earlier than six months from public disclosure of the plan. It is important to mention here that such a plan when approved becomes irrevocable and it has to be carried as per plan. Such plan should not entail any trading of securities for market abuse.

Every promoter, key managerial personnel and director of a listed company are under obligation to make initial disclosures about his securities in the company and under obligation of continual disclosures. If they make any transaction in excess of ten lakh rupees (10,00,000 INR) of buying or disposing of any securities in any calendar quarter, they have to disclose it within two trading days. A listed company can also require any connected person to make disclosures about its shareholding and trading in securities of the company. The board of directors of listed companies are required to make a code of fair disclosure of UPSI and a code of conduct for regulating, monitoring and reporting of trading by its employees and other connected persons.

In a 24,000 crore (\$ 4 billion) deal of Sun Pharmaceuticals to buy shares of Ranbaxy Laboratories which are majority owned by Daiichi Sankyo, a petition was filed in Andhra Pradesh High Court that the Court should direct SEBI, Bombay Stock Exchange and National Stock Exchange to probe into insider trading in this deal. The plea was that there was a sudden unusual increase in price and turnover during six trading days before the deal was announced. There was a jump of 34 and 8.18% in shares of Ranbaxy before six trading days and on the trading day, respectively, before the announcement and over 3.74 crore shares were transacted on these exchanges between 2 and 4 April 2014 which were about five times the daily trading volume. It was alleged that Silverstreet Developers and Sun Pharmaceuticals were in possession of price sensitive information and they have benefitted at the expense of retail investors. Silverstreet is a limited liability partnership of two subsidiaries



of Sun Pharmaceuticals.<sup>15</sup> However, the petition was disposed of by the High Court that the matter is being investigated by SEBI so there is no ground to keep status quo on the proposed merger.

SEBI has penalized many corporate executives of top companies, namely Wipro, ITC and Mahindra & Mahindra because they sold their shares violating Insider Trading Regulations. Executives had purchased shares either from the market or received them under employee stock options (ESOPs). They either sold their shares during no transaction period that proceeds generally before quarterly results and annual general meetings or had failed to inform stock exchanges about such transactions.

Fight against insider trading by SEBI is reported to have received a setback in another Supreme Court decision where its appeal in case of insider trading against a top fund manager has been dismissed. Since 1992 when Insider Trading Regulations were made by SEBI, no insider has faced any criminal prosecution in the country. The alleged insider in the case was Asia Pacific head of Alliance Capital Mutual Fund, and he was barred from securities market for a period of five years for his indulgence in unfair trade practices and on the ground that he had sold some shares that impacted Alliance's valuation when it was an acquisition target.<sup>16</sup>

Front running is another new malpractice emerging in Indian securities market. It is regulated by SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003. In the case of *Vibha Sharma v SEBI*<sup>17</sup>, a liberal interpretation to the definition of front running was given and it was held that front running is detrimental whether it is done by an intermediary or a third person.

## 15.7 Collective Investment Schemes

SEBI has investigated frauds through collective investments schemes launched by real estate developers.<sup>18</sup> Around 50–60 such developers were investigated for possibility of Collective Investment Scheme Violations by these developers. Many complaints were received by SEBI from investors who were duped by such schemes. Under these schemes, companies raise funds from public either to invest in a project or investment scheme proposed by them from the capital collected by them and returns are shared on pro rata basis. For example, investors are lured to invest in buying a land to be later on developed into a residential or commercial complex. Investors are either promised huge returns or companies offer to buy back properties at considerable appreciation to the original investment. It has been found that investors are either not given any return or only initially they are given small returns.

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<sup>15</sup> *SC puts on hold Sun-Ranbaxy deal till insider trade verdict*, The Economic Times, April 30, 2014.

<sup>16</sup> <https://economictimes.indiatimes.com/sc-dismisses-sebis-plea-for-insider-trading-charges-against-samir-arora/articleshow/33834873.cms?from=mdr>.

<sup>17</sup> [www.sebi.gov.in/cms/sebi\\_data/attachdocs/1378273462653.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1378273462653.pdf).

<sup>18</sup> *SEBI lens on Realtors for fraudulent deals*, The Economic Times, Mar. 25, 2013.

There are other types of agro-related Collective Investment Schemes like emu farming or potato farming. Here, certain entities pooled in money collected from investors under investment contracts for investing in such schemes with a promise of good returns. These entities claimed that they do not fall under jurisdiction of SEBI since they are not structured organizations like partnerships or companies and their business is not on the lines of business which fall under purview of SEBI. Around Rs. 10,000 crore were raised through such schemes by these entities. SEBI has now been given power to deal with such types of schemes. SEBI decided to declare illegal mobilization of funds as a fraudulent and unfair trade practice, and now it is investigating them under SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003. This decision was taken in view of increasing fraudulent money pooling activities by groups, namely Saradha, Rose Valley and Sumangal.<sup>19</sup> Many entities running collective investment schemes have been directed to wind up and refund money to the investors.<sup>20</sup> For example, Osian Art Fund run by art collector Neville Tuli was asked to wind up its scheme and refund the money to investors with interest of 10% p.a.<sup>21</sup> The Saradha Group raised Rs. 2460 crore from investors through its pyramid schemes. The group had registered 239 companies and used four companies to launch such schemes. The group was not able to repay about 80% of the amount that it had raised. The group had mobilized deposits in cash, and 90% of this amount was not deposited in banks. It had paid about Rs. 820 crore as commission to its marketing agents. The group has repaid only Rs. 447 crore to investors.<sup>22</sup> The case has been investigated by the Serious Fraud Investigation Office (SFIO), which has found serious violations of provisions of company law by the companies involved.<sup>23</sup>

In order to curb the practice of floating collective investment schemes in future, the Securities Laws (Amendment) Act, 2014, now provides that any unregistered scheme having a corpus of Rs. 100 crore or more would be deemed to be a collective investment scheme and will fall within jurisdiction of SEBI.<sup>24</sup> Earlier there was confusion whether such schemes fall under the jurisdiction of SEBI or the Reserve Bank of India or Ministry of Corporate Affairs. SEBI in a case decided by the Supreme Court of India (SC) in 2017 informed that it has referred over 1000 cases to other appropriate agencies for further probe, since the investigation did not fall under its purview. The case was filed by an NGO for a proper investigation into chain-money schemes or illegal chit funds or Ponzi schemes, and the SC had sent a

<sup>19</sup>SEBI declares illegal money pooling as 'fraudulent', Livemint, Aug 12, 2013.

<sup>20</sup>Many Unregulated Investment Plans, <http://mobilepaper.timesofindia.com/mobile.aspx?article=yes&pageid=18&sectid=edid=&edlabel=ETD&mydateHid=18-04-2013&pubname=Economic+Times+-+Delhi&edname=&articleid=Ar01800&publabel=ET>.

<sup>21</sup><http://www.moneylife.in/article/osians-sebi-asks-the-art-fund-to-shut-shop-and-refund-investors-money-with-10-interest-pa/32233.html>.

<sup>22</sup>Investors lost Rs. 1983 crore in Saradha Ponzi scheme: Audit, The Economic Times, Apr 28, 2014.

<sup>23</sup>SFIO submits final Saradha scam report, The Economic Times, Sept 10, 2014.

<sup>24</sup>Bill gives SEBI sharper whip to crack at Ponzi schemes, The Economic Times, Aug. 7, 2014, p. 13.

notice to SEBI inquiring why enough steps are not taken up to protect people from such scrupulous schemes (Sucheta 2017). SEBI is now considering to relinquish power to regulate collective investment schemes as it does not have proper system to curb such practices (Laskar 2017).

## 15.8 Mutual Funds

SEBI has also started being strict with mutual funds whose net worth is below the required levels. It is not clearing applications for New Fund Offers by such houses, although they have to comply with minimum capital requirements by 2017. SEBI had announced mutual funds to meet Rs. 50 crore minimum net worth requirement within three years as part of its drive to discourage non-serious funds to remain in the business. Earlier, there was a requirement to maintain Rs. 10 crore as net worth. Now, it is not allowing any new scheme under a clause empowering it to exercise such a power in interim too. SEBI wants fund houses to be well capitalized in order to meet high redemption pressure.

Mutual fund sector in India is growing continuously. It has grown with net fund mobilization to the tune of ₹3.43 trillion in 2016–17. SEBI is now working on asset classifications for mutual funds and is dividing such funds into three schemes, equity, debt and hybrid. It is reported that there are 42 mutual funds in India offering 2000 schemes and dealing with 19.5 lakh crore INR (Zachariah and Nishanth 2017).

## 15.9 Stock Exchanges

Besides regulating the public issues by the companies, SEBI is also regulating the stock exchanges where companies are listed. In 2012, SEBI overhauled ownership and governance norms for stock exchanges and implemented new stock exchanges and Clearing Corporation Regulations. SEBI had allowed stock exchanges to raise initial public offers and list their own shares on the exchange like shares of any other company. However, many clauses specially related to definitions of trading members, shareholding patterns between public shareholders and trading members, associated companies, persons acting in concert, etc., were found to be ambiguous so SEBI had to review them (Laskar 2013).

A special audit of Multi Commodity Exchange was conducted by the PricewaterhouseCoopers that submitted its report to Forward Markets Commission, earlier regulator for commodity market in India.<sup>25</sup> The report highlighted a number of irregularities since its inception between the periods of 2003 and 2013. Financial Technologies (India) Ltd (FTIL) is promoter of MCX, which owns National Spot Exchange Ltd (NSEL) by 99.9%. NSEL was hit by a payment crisis of around Rs. 5600 crore.

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<sup>25</sup>Forward Markets Commission merged with the Securities and Exchange Board of India in 2015.

As per the report, FTIL and few related parties of MCX conducted ‘wash trades’ on the bourse without any intention to make genuine market transaction. There were 235 related parties and 676 additional entities or individuals which were involved in transactions. These additional entities are presumed to be directly or indirectly related to either MCX or FTIL group as common directors or shareholders. Violation of regulatory norms and transfer pricing were found to be two important issues involved here.<sup>26</sup>

As stated above, the National Spot Exchange Limited faced a payment crisis of around Rs. 5600 crore where nearly 18,000 of its investors allegedly lost money.<sup>27</sup> In this case, about 24 borrowers had raised money on NSEL as a platform by pledging non-existent commodities. The scam came to notice when no commodities were found in the warehouses. Steps were taken to recover money from the defaulters, and statutory auditors of NSEL were also questioned for not raising the issue in their audit reports (D’Souza 2014). Investors alleged that high profile brokers were also privy to the fraudulent deals. It was alleged that most of such brokers were also wealth managers to investors and were able to sell them NSEL as an arbitrage product by giving false assurance of safety and existence of stocks in NSEL warehouses (Das 2014). NSEL case has been reported to be spectacular example of Government’s failure to protect the interests of investors despite having the prior knowledge.<sup>28</sup>

In order to protect against excessive price fluctuations of securities on stock exchanges, SEBI had fixed circuit filters. It imposed a 20% price band on stocks that are components of an index derivative but not in the derivative segment itself. However, it had decided that the stocks that are part of futures and options segment will have no circuit filters.<sup>29</sup>

SEBI is now working to overhaul governance norms in stock exchanges as some issues were reported relating to ownership, governance and public interest directors in stock exchanges. Some amendments will be proposed in Stock Exchange and Clearing Corporation Regulations, 2012.<sup>30</sup>

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<sup>26</sup> *Known parties manipulated trade in MCX*, The Economic Times, April 30, 2014.

<sup>27</sup> *Jignesh Shah files fresh bail plea in HC, Earlier bail was denied on the ground that investigation is still on*, Press Trust of India, June 29, 2014, [http://www.business-standard.com/article/specials/jignesh-shah-files-fresh-bail-plea-in-hc-114062900257\\_1.html](http://www.business-standard.com/article/specials/jignesh-shah-files-fresh-bail-plea-in-hc-114062900257_1.html).

<sup>28</sup> N Sundaresha Subramanian, *NSEL crisis: Lessons aplenty for everyone Regulators, borrowers, employees, investors learn some old lessons in new ways*, Business Standard, July 29, 2014, [http://www.business-standard.com/article/specials/nsel-crisis-lessons-aplenty-for-everyone-114072901326\\_1.html](http://www.business-standard.com/article/specials/nsel-crisis-lessons-aplenty-for-everyone-114072901326_1.html).

<sup>29</sup> *SEBI expands lists of stocks with circuit filters, Currently, there was no circuit filter on stocks, which are components of an index, traded in the F&O segment*, Business Standard, February 7, 2014, [http://www.business-standard.com/article/markets/sebi-expands-lists-of-stocks-with-circuit-filters-114020601214\\_1.html](http://www.business-standard.com/article/markets/sebi-expands-lists-of-stocks-with-circuit-filters-114020601214_1.html).

<sup>30</sup> *SEBI to overhaul governance norms for stock exchanges*, Livemint, Nov 2017, <http://www.livemint.com/Money/WFNk9ZAXUJM5qeLYKZIM8M/Sebi-to-overhaul-governance-norms-for-stock-exchanges.html>.

## 15.10 Mergers and Amalgamations

In 2011, SEBI revised takeover code and came up with SEBI (Substantial Acquisition of Shares and Takeover) Regulations. This revision was done with a view to prohibit hostile takeovers of companies. Under the regulations, in cases of substantial acquisitions of shares or voting rights, acquisition of control, indirect acquisitions of voting rights or control and voluntary offer, if the acquisitions exceed thresholds, open offer will be mandatory to be given by the acquirer. Certain exemptions have also been included in the Takeover Regulations where acquirer will not be required to make an open offer. In this respect, SEBI exempted chairman and managing director of Educomp Solutions from making an open offer for his proposed acquisition of 7.5% in the company that would increase his shareholding from 28.70 to 36.20% and would increase promoter group's shareholding from 37.30 to 44.80% in the company. The ground taken up for this exemption was that proposed acquisition would not lead to any change in the control of management of the company. It is to be noted here that the chairman had taken a loan of Rs. 46 crore for the company and pledged 91.80 lakh shares of the company as security with Macquarie. The pledge was invoked by Macquarie, and shares were transferred to its name. SEBI was of the opinion that since the loan amount has been settled and Macquarie is willing to transfer those shares and moreover no fresh consideration is required for the proposed transfer of shares to the acquirer as pursuant to such transfer the acquirer would get back his shares which he had pledged. It was further of the opinion that the company would continue to follow mandatory minimum public shareholding norms for public listed companies.<sup>31</sup> The company came under restructuring as its debts had increased and it was reported that negotiations for its acquisitions reached an advanced level. It was also reported that the potential acquirer may invest about Rs. 1800 crore (\$300 million) through open offer as well as primary shareholding (Sharma and Kurian 2014). However, it has reported a consolidated loss for 11 consecutive quarters and it is expected to undergo strategic debt restructuring by conversion of debt to equity (Vishwanath 2016). It has now applied for revival under Insolvency and Bankruptcy Code, 2016, for debt restructuring before National Company Law Tribunal.<sup>32</sup>

SEBI has mandated all listed companies to take SEBI's approval for all amalgamations, mergers and demerger deals which so far they have been doing after approval of National Company Law Tribunal (NCLT) and approval of stock exchanges where securities are listed. Companies will have to incorporate observations of SEBI on the proposed scheme before approaching (NCLT). SEBI is of the opinion that many such deals involve complex issues which are not always in the best interests of minority shareholders. It now wants companies to obtain the approval of at least two-thirds of minority shareholders, and shareholders' approval should be obtained through

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<sup>31</sup>SEBI exempts Educomp's CMD Shantanu Prakash from making open offer, The Economic Times, Jun 3, 2013, [http://articles.economictimes.indiatimes.com/2013-06-03/news/39714544\\_1\\_minimum-public-shareholding-norms-acquirer-promoter-group](http://articles.economictimes.indiatimes.com/2013-06-03/news/39714544_1_minimum-public-shareholding-norms-acquirer-promoter-group).

<sup>32</sup><http://www.thehindu.com/business/educomp-pins-hopes-on-insolvency-code/article18619356.ece>.

postal ballot and e-voting on a special resolution proposed to ratify the transaction. No objection certificate of stock exchange will also be sent to shareholders at the time of their approval. Companies are now mandated to disclose the scheme valuation report obtained from independent chartered accountant, fairness opinion and audit committee's observations on the scheme for public scrutiny for 21 days.<sup>33</sup>

## 15.11 Investment Advisors

SEBI has made it mandatory for any person or a company seeking to advise investors to register with it. So far, it has authorized 11 entities to act as investment adviser under new SEBI (Investment Advisors) Regulations, 2013.<sup>34</sup> Under these regulations, investment advisors will undertake risk profiling of clients and disclose to a prospective client, all material information about itself including its business, disciplinary history, the terms and conditions on which it offers advisory services, affiliations with other intermediaries and other information which may be necessary for the client to take an informed decision on whether or not to avail its services. These regulations aim at ensuring more transparency in the capital market. SEBI has proposed to amend these regulations to bring in its ambit all advisors who advise investors.<sup>35</sup> SEBI has also released a consultation paper with proposal for clear segregation between the investment advisory activities and distribution/execution services.<sup>36</sup>

## 15.12 Investigations by SEBI

Since its inception in 1992, SEBI has undertaken 1772 cases for investigation and out of them completed 1539 cases till 2014. During 2016-17, it investigated 245 new cases and completed 155 cases. Out of 155 cases taken up for investigation, 76% cases were related to market manipulation and price rigging, 3% were manipulations related to issues, 14% related to insider trading, 1% related to takeovers and 6% were miscellaneous cases (Table 15.2).<sup>37</sup>

<sup>33</sup>Listed companies must now seek SEBI nod for all M&A deals, The Economic Times, Feb. 6, 2013, [http://articles.economicstimes.indiatimes.com/2013-02-06/news/36949909\\_1\\_sebi-nod-capital-market-regulator-observation-letter](http://articles.economicstimes.indiatimes.com/2013-02-06/news/36949909_1_sebi-nod-capital-market-regulator-observation-letter).

<sup>34</sup>*I-Sec, 10 others get SEBI nod to act as investment advisors*, Business Standard, Friday, Aug 31, 2013.

<sup>35</sup>All advisers could soon be accountable to SEBI, Livemint, Sep 30 2016 <http://www.livemint.com/Money/Fr7DDh1FHvJsQIXRbT7zMK/All-advisers-could-soon-be-accountable-to-Sebi.html>.

<sup>36</sup>Do proposed SEBI rules for advisers & distributors favour investors? ET Bureau, July 3, 2017, <https://economicstimes.indiatimes.com/wealth/invest/do-proposed-sebi-rules-for-advisers-distributors-favour-investors/articleshow/59397444.cms>.

<sup>37</sup>SEBI annual report 16-17, pp. 146-147

**Table 15.2** Nature of investigations taken up and completed by SEBI

Particulars	Investigations taken up										Investigations completed									
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17						
Market manipulation and price rigging	56	73	86	67	41	84	185	51	37	41	86	60	118							
'Issue'-related manipulations	6	35	43	6	3	9	8	2	4	52	3	20	5							
Insider trading	28	24	11	11	10	12	34	15	21	14	15	20	15							
Takeovers	4	2	3	6	3	2	3	4	2	2	3	2	4							
Miscellaneous	10	20	12	16	13	26	15	10	10	10	15	21	13							
Total	104	154	155	108	70	133	245	82	74	119	122	123	155							

Compiled from SEBI annual reports available on <https://www.sebi.gov.in>

The above table clearly indicates that major areas of concern for SEBI are market manipulation and price rigging as in this area only maximum investigations are taken up by it since 2010. Insider trading issues lie at second place in investigations taken up by SEBI. It is also indicative of the time taken by SEBI in completion of investigations.

### 15.13 Few Orders by SEBI<sup>38</sup>

1. *Irregularities in initial public offers in the case of M/s. Karvy Computershare Private Limited*: Certain irregularities were noticed by SEBI in IPOs of different companies, and after the investigation, it was found that few key operators had opened demat accounts (affluent accounts) in fictitious names and acquired shares offered to retail investors. After allotment of shares, they were transferred to demat accounts of key operators and then transferred to real beneficiaries who were financiers in the process.
2. *Collective Investment Scheme by M/s. Green Ray International Limited*: The company had collected Rs. 45.50 crore through illegal means without registration with SEBI. SEBI directed the company and its directors/promoters to wind up the existing collective investment schemes and repay money to investors.
3. *Restrictions on M/s. Prayag Infotech Hi-rise Ltd*: The company was engaged in fund mobilizing activity through issue of redeemable preference shares to more than 49 persons without complying with the provisions of the Companies Act and SEBI regulations. The company was restricted from issuing any prospectus or offer document or advertisement from raising money from public.
4. *Collective Investment Scheme by M/s. KBCL India Limited*<sup>39</sup>: SEBI has directed the company and its directors not to collect any money from investors or launch or carry out any CIS and to wind up existing scheme and refund the money to investors.
5. *Restrictions on M/s Manglam Agro Products Limited and M/s Greater Kolkata Infrastructure Limited*<sup>40</sup>: In both the orders, SEBI has directed the companies not to mobilize funds from the investors. The companies and their directors are prohibited from issuing any prospectus or any other offer document or issue advertisement for soliciting money from the public for the issue of securities, in any manner whatsoever, either directly or indirectly. Both the companies were engaged in fund mobilizing activity through issue of secured non-convertible redeemable debentures to more than 49 persons without complying with the relevant provisions of the Companies Act and provisions of the SEBI (Issue and listing of Debt Securities) Regulations, 2008.

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<sup>38</sup>SEBI Bulletin, Vol 12, Number 3, March 2014.

<sup>39</sup>SEBI Bulletin, Vol. 12, Number 7, July 2014, p. 891

<sup>40</sup>ibid.



6. *Restrictions on Tjaria Polypipes Limited and Others*<sup>41</sup>: Appellants were restrained by SEBI from dealing in the securities market completely for a period of 7 years for various violations under the SEBI Act, SEBI (Fraudulent and Unfair Trade Practices) Regulations, 2003, and SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. They appealed to Securities Appellate Tribunal (SAT). It held that since IPO proceeds were used to refund inter-corporate deposits (ICDs), funds raised through ICDs were in the nature of bridge loans and hence as per ICDR provisions all bridge loans also must be disclosed. This fact should have been disclosed through the prospectus or immediately after the board meeting. SAT further held that information relating to an amount to the tune of 25% of the IPO proceeds was not just a material once it was substantively material for the market to correctly evaluate the advantages and risks of an IPO. Hence, the contention of the appellants that since money was used for normal business and the information did not pose any risk to the investors did not have any merit and was therefore rejected.

## 15.14 Conclusions

In the end, it can be concluded that SEBI has been trying hard not only to regulate but develop securities market so that numbers of manipulations are reduced. It is trying to increase transparency and simplify the process of initial public offers in primary market. It has to prevent overpricing of initial public offers and make promoters of companies to take care of investors' interest. It had even warned its officials to avoid former colleagues working for companies that are fighting against it in order to avoid undue influence and lobbying (Mascarenhas 2014). It is continuously reviewing its regulations in order to keep pace with emerging complexities. It increased investors' categories to fetch investment in shares of companies; it provided two-way fungibility to Indian Depository Receipts, introduced alternative investments funds and regulations for them and so on. It is also keeping an eye on securities-related advises on social networking sites. However, there is a need that SEBI should conduct proper research before proposing new regulations as well as modifying existing regulations. For example, new options offered to promoters for reducing their shareholding might not have been adopted by them due to other regulations and provisions of the Companies Act. It was expected that promoters might have to sell their shares at less than market value because rights issue option has minimum subscription requirement which would be difficult to maintain since this offer will be only for public shareholders and will have pricing limitations, etc., whereas bonus shares can be issued only by capitalization of profits not otherwise and such shares would have to be distributed free to public shareholders by the promoters. It was not a perfect

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<sup>41</sup>SEBI Annual Report, 2016–17, p. 215

method but promoters of few companies had opted for it after comparing the cost and effort of making public issue.<sup>42</sup>

Surveillance team of SEBI is keeping a close watch on the market to spot abnormal or suspicious trading patterns. Anything other than regular trading pattern will come under its scrutiny and will be investigated further to prevent unscrupulous elements from destabilizing market. The team had noted that an individual retail investor purchased shares worth Rs. 2000 crore on a single day when market had reached its new heights. It was investigated, and the investor was sent a notice by SEBI (Tamal 2013).

In view of the fact that now banks are announcing companies, their promoters as well as directors as wilful defaulters, SEBI has also started work with regard to mandatory annual information memorandum for listed companies in order to reduce undue litigation from the regulators. It has barred wilful defaulters from raising equity in order to deter promoters from defaulting on repayments even when they have sufficient money to repay. It is revising rules for persons 'eligible' to raise money through public issue. Such defaulters cannot raise funds through equity or bonds, occupy board positions or set up intermediaries like brokerage firms or mutual funds (Choudhury 2016).

After Sahara case, SEBI has been given powers of recovery, access to information, search and seizure, power to oversee collective investment schemes and consent orders.<sup>43</sup> SEBI can now attach properties of defaulting companies and sell them to realize monetary penalties imposed by it.<sup>44</sup> It has now access to phone records. It can call for information and records from any person including any bank or any other authority, board or corporation constituted under any Central or State Act if the information will be relevant to any investigation or inquiry undertaken by it in respect of transactions in securities. It can also share information or call for information to any other authority, whether in India or outside India, for prevention and detection of violations relating to securities laws. For this purpose, it may enter into any agreement or arrangement or understanding with such other authority with prior approval of the Central Government. It can exercise power of search and seizure without approval of Chief Metropolitan Magistrate. Under consent order, an entity can settle with SEBI any administrative or civil proceedings by paying money without admitting or denying guilt. Consent orders are like an out of court settlement in the context of charges of violation of securities laws. For example, director of Suzlon Energy settled under consent order delayed implementation of a revised code of conduct at the company for Insider Trading Regulations (Zachariah and Nishanth 2014). The Central Government may by notification establish or designate as many Special

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<sup>42</sup>SEBI may make it easier to comply with public shareholding norms, Livemint, Jan 10, 2013.

<sup>43</sup>Securities Laws (Amendment) Act, 2014.

<sup>44</sup>SEBI has started recovery proceedings. During 2015–16, 614 attachment notices were issued against bank accounts/lockers, demat accounts. The recovery proceedings were completed in 80 non-collective investment cases during 2015–16. During 2015–16, SEBI recovered INR 224.6 crore under its recovery mechanism as compared to INR 19.2 crore recovered during 2014–15. The data is provided in the annual SEBI report of 2015. This data indicates that SEBI is working with due diligence to initiate proceedings and execute its orders and recovery proceedings.

Courts as may be necessary in order to provide speedy trial of offences relating to securities.<sup>45</sup> It is hoped that the enforcement action would go up and ability to access call data records will make it easier for SEBI to prove insider trading charges (Zachariah and Nishanth 2014).

These new powers are a challenge to SEBI because they have to be used only when necessary and should not be misused. SEBI has been trying to regulate new issues coming before it but even today investors are not confident of securities market in India. It is too complex. There is an urgent need to simplify security-related matters. SEBI needs to hire people who are well versed with functioning of securities market. Its regulations cannot exist in isolation. Therefore, there is a need to be careful while drafting regulations in order to avoid overlaps. For example, there was confusion between Foreign Institutional Investor (FII) and Foreign Direct Investment (FDI) which has now been sorted out. Further, SEBI needs to act upon information supplied or alerts given to it by other agencies and authorities. Delay in action by it cannot be excused on the ground of independent investigations.

Number of companies is increasing day by day, and with them chances of securities-related frauds are also multiplying because companies deal with free money. How so much of information will be processed by SEBI when we know that clever brains work for companies? SEBI has suggested for fixing depository framework<sup>46</sup> and prohibition on opening of bank accounts without proper verification.<sup>47</sup> Recently, senior counsel in Sahara case asked SEBI to cooperate with the company. With these expectations of defaulter companies how SEBI will meet this challenge it has to be seen? With these new powers, challenges before SEBI have increased. It has to prove that it can improve effective governance of securities market. We hope that there will be reduction in overruling of orders of SEBI by Securities Appellate Tribunal (SAT). In the very famous fraud case of Satyam Computers Ltd, SEBI's order of a penalty of Rs. 1849 crore with 12% rate of interest, in total a disgorgement amount of over Rs. 3 000 crore on Ramalinga Raju and four others, was stayed by SAT although restriction on them from accessing the market for fourteen years was upheld.<sup>48</sup> However, SAT found SEBI's order in uniformly restraining all the appellants from accessing the securities market for 14 years without assigning any reasons as unjustified.<sup>49</sup>

As stated earlier, challenges before SEBI are many due to the fact that still securities market is not fully developed and financial literacy is low among Indians. SEBI needs to take actions after careful inspection and investigation of all relevant proceedings. For example, a list of shell companies was issued by Ministry of Corporate

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<sup>45</sup>S. 26A, Securities Laws (Amendment) Act, 2014.

<sup>46</sup>Ashish Rukhaiyar, *Fix depository framework to avoid IPO scams: SEBI Panel*, The Financial Express, July 2, 2013.

<sup>47</sup>Business.mapsofindia.com/ipo-india/scams.html visited on Aug 16, 2013.

<sup>48</sup>SAT stays SEBI penalty on Satyam's Raju, *Upholds ban*, The Economic Times, Sept. 9, 2014.

<sup>49</sup>SAT asks SEBI to review quantum of punishment in Satyam case, Business Line, May 21, 2017 available at <http://www.thehindubusinessline.com/markets/sat-asks-sebi-to-review-quantum-of-punishment-in-satyam-case/article9696041.ece>.

Affairs and many directors of such companies were disqualified. SEBI suspended trading for such companies through their stock exchanges where their securities were listed. It has now formed a committee to hear cases of companies and directors who complained to have been classified as shell companies because of technical errors.<sup>50</sup> In the words of present SEBI Chairman, SEBI is taking many policy initiatives for deepening securities market, increasing investor confidence and trust in the market by increasing governance norms, effective supervision along with enforcement actions.<sup>51</sup>

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<sup>50</sup>Shell companies: SEBI panel to look into complaints of errors in classification, *Livemint*, Nov. 21, 2017 available at <http://www.livemint.com/Money/vvapH1LhbKYVCdNZjsSuyO/Shell-companies-Sebi-panel-to-look-into-complaints-of-error.html>.

<sup>51</sup>Chairman's statement, SEBI bulletin, 2016–17.

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# Chapter 16

## UN Global Compact and Code of Conduct: The Case of Turkey



Arzu Ozsozgun Caliskan

### 16.1 Introduction

The activities of employees connect an organization with its stakeholders and the unethical decisions and activities commonly undermine the performance and abilities of many organizations (Cleek and Leonard 1998; Adams et al. 2001). On the other hand, embedding ethical standards produce increased financial performance, reduced cost structures, product differentiation, and brand equity (Erwin 2011). Thus, establishing ethical code of conduct is considered by the corporations that aimed to compete domestically and globally and so be successful in its business activities as an integral part of their success (Adam and Rachman-Moore 2004; Rodriguez-Dominguez et al. 2009). Corporations that aimed to compete domestically and globally and so be successful in its business activities consider establishing ethical code of conduct as an integral part of their success (Adam and Rachman-Moore 2004). Especially, after the recent scandals resulting bankruptcies such as Enron, WorldCom, Global Crossing, HIH Insurance, Parmalat had unexpected and negative impacts on the financial markets and public and produce large increase in adopting an organizational ethical code of conduct (Adams et al. 2001; Adam and Rachman-Moore 2004; Rodriguez-Dominguez et al. 2009). Because of enacting codes guide individual behavior and protect the corporation from the illegal and unethical behavior of employees. Its significance stems from the belief that the codes are a symbol of companies' commitment to both internal and external stakeholders to complying rules of ethics (Adams et al. 2001). From the point of view, the configuration of ethical codes in a firm can produce both responsible individual behavior and also "responsible organization." The responsible organization refers to deeply internalize the values by clearly defining and prioritizing the responsibilities in the strategy and policy of an organization. Especially, during the last decade of the twentieth century, arising in the ethical and conduct issues also resulted in broadened the scope of stakeholders such as employees, customers, managers, economists, shareholders,

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public servants (Nijhof et al. 2003) and industry of social auditors, consultants, and non-governmental organizations (Egels-Zandén 2014). The global business practices have become routine activity for firms in recent years so the effects of business operations on the earth and social life also have become a factor influencing the entire world globally. Thus, although the main reason for the existence of a company is the creation of positive value for its stakeholders; industrialization and large-scale production that aim to satisfy human needs have also resulted in both devilish consumption and global warming, air and water pollution, depletion of natural and environmental resources, and damages to human health and quality of life (Cabezas et al. 2004; Setthasakko 2009). The greater negative impact of global problems posed by rapid technological and economic development necessitates global solutions and initiatives. In this context, the United Nations Global Compact—hereafter UNGC—initiative was established in 2000 Kofi Annan as a leadership platform for the development, implementation, and disclosure of responsible corporate policies and practices. The strategic policy initiative involves a universally accepted set of principle that presented for businesses. The aim behind the principles is encouraging businesses to align their operations and strategies with committed values in the areas of human rights, labor, environmental, and anti-corruption (UNGC). Corporations, economy, and community are integral parts of a system that correlate to each other. For that reason, when firms align their operations and strategies with the principles, they also can help ensure that markets, commerce, technology, and finance advance in ways that benefit economies and societies everywhere. In order to actualize the idea, business organization could use code of conduct which is important for organizations to align their operations and strategies with committed values. Therefore, the study mainly focuses on code of conduct and United Nations Global Compact. In this context, the structure of this study as follows. The next section reviews the concept of the code of conduct. The third section explores UN Global Compact. The fourth section analyzes UN Global Compact and code of conduct in Turkey and the last part of the study presents the conclusions.

## 16.2 Code of Conduct

Code of conduct is important for the firms and stakeholders, since the unethical activity of corporations can have significant costs for both of them. Provision of consistent normative standards for employees, avoidance of legal consequences, and promotion of public image are some of the reasons for firms to have code of conduct (Schwartz 2001). The social costs of unethical practices of business are hard to measure, but it mostly affects the organizations negatively. The recent corporate scandals, such as Enron, Parmalat, WorldCom, Tyco and Lehman Brothers have increased attention to code of conduct. However code of conduct is not new, the emergence of code of conduct goes back to the J.C. Penney Company “Penney Idea” in 1913 and, for example, Johnson & Johnson’s corporate ethics statement originated in the 1940s. In the period between the late 1960s and the early 1980s, international and domestic

scandal experienced (Adams et al. 2001) and the performance of organizations for the business owners has changed (Cleek and Leonard 1998). In addition to that, especially during the recession of the early 1980s, the media interest on the management failures that produce plant closing, layoffs, and numerous bankruptcies increased. As a result, organizations' ethical behaviors have begun to be monitored more closely by the media, academia, consumers, and business (Cleek and Leonard 1998) companies have started to institute codes of conduct as symbols for both internal and external stakeholders of their commitment to ethical practices and the concerns with organizational code of ethics have intensified in the 1990s (Adams et al. 2001).

When the literature related to code of conduct is reviewed, it is seen that code of conduct has been referred to as code of ethics, code of practice, corporate philosophy, corporate credo, corporate ethics statement, mission statements, or value statements, business principles, operating principles, business code (Schwartz 2004; Canary and Jennings 2008; Schwartz 2001; Adams et al. 2001; Carasco and Singh 2003; Cleek and Leonard 1998; Erwin 2011; Kaptein and Schwartz 2008). In the literature, there are many definitions for code of conduct. Code of conduct can be defined as managerial and legal tools, it is a set of prescriptions developed by and for a company to guide present and future behavior on multiple issues of at least its managers and employees toward one another, the company, external stakeholders, and/or society in general (Kaptein and Schwartz 2008). Stohl et al. (2009) specify they are the public statements of corporate principles and rules of conduct that govern inter-organizational and intra-organizational practices and relations. According to Stevens (1994), code of conduct is written documents which are used as a managerial tool that intended to impact employee behavior by making explicit statements as to desired behavior. Code of ethics as a formal document which consist of moral standards used to guide employee and/or corporate behavior has three components. The first component is being moral standards to be applied. The standards as a value system, aspirational ideals, and guidelines provide guidance to employees to understand what behavior is morally acceptable or improper. The second component of the standards is generally employee behavior or conduct, but also includes organizations' behavior. Employee behavior and organization behavior might be considered as representing behavior "against" or "on behalf of" the firm, as a corporation can only truly "act" through its agents. The last component is that corporate code of conduct as a document itself is written, distinct, and formal (Schwartz 2004).

For firms and stakeholders, code of conduct is more than simply a statement of ethical principles (Canary and Jennings 2008). Code of conducts might be viewed as a component of enhancing corporate reputation and brand image. For this purpose, the codes could be used to send right message to about good business practices, internally and externally. If a company disclosed its code of conduct, when the company is accused of unethical behavior, which will be seen as exception, not the rule. Having code of conduct could help to create cohesive corporate culture and provide a mechanism for a corporation to operationalize its value (Carasco and Singh 2003) since they affect the organizational culture by governing the actions and conduct of employees through the promotion of ethical business practices, thereby avoiding legal consequences (Erwin 2011). Codes of conducts are most often perceived as



tangible evidence that an organization has recognized a need for, and has made a commitment toward, ethical behavior. Codes tend to make employees feel better about and more secure in their organizations while customers and stakeholders have greater faith in the company (Stohl et al. 2009).

### 16.3 The United Nations Global Compact

The United Nations Global Compact is a principle-based initiative which is launched in 2000. In his speech in 1999, the former UN general secretary Kofi Annan emphasized that rapid spread of globalization produce unsustainable imbalances and inequities, and in the circumstances, universal human values and rights could be largely ignored by the firms and individuals to attain greater benefit (Kell 2003). It is claimed by Annan that there is need shared values that lead business to behave more responsible and contribute to economic development (Williams 2007).

The UN Global Compact is a principle-based initiative that reflects broadly defined norms for corporate behavior without any monitoring (Rasche et al. 2013). After the 1999 World Economic Forum in Davos, nine principles are formulated by the Annan and a group of business leader. The principles were in the areas of human rights, labor standards, and environmental practices. The tenth principle against corruption was added in June 2004 (Kell and Levin 2003; Williams 2007). Thus, as it is seen in Table 16.1, the principles are classified into four cornerstones: human rights, labor, environment, and anti-corruption. The Universal Declaration of Human Rights (1948); the Rio Declaration on Environment and Development (1992); the International Labor Organization's Fundamental Principles and Rights at Work (1998); and the UN Convention against Corruption (2003) are the source of where the principles come from (Williams 2007; Ruggie 2001; Kell and Ruggie 1999).

Businesses are the primary driver of globalization and mainstreaming ten principles in business activities around the world and facilitating actions in support of broader UN goals can contribute a more sustainable and inclusive global economy (UNGC 2014a). The UN Global Compact initiative is leadership platform that aimed encouraging business for the development, implementation, and disclosure of responsible and sustainable corporate policies and practices (UNGC 2014a). However, it is not possible to resolve all of the disadvantages of global capitalism by the Global Compact. It could be the solution for some problems by establishing a basis for a foundation of shared values and harnessing the skills and resources of the private sector (Kell and Levin 2003).

The Global Compact is the last step in the evolution of the "international human rights regime," and it represents the rights of "humankind" or our collective humanity. The development could be named as "third generation," and it is different from first and second generation since it emphasizes a positive-sum rather than zero-sum rights of the collective (Stohl et al. 2009). The Global Compact is *a public and private, global and local, as well as voluntary initiative* (Rasche et al. 2013) and aimed to encourage business to work with United Nations. Instead of enforcing participants' behaviors

**Table 16.1** The UN Global Compact principles

<i>Human rights</i>
1. Businesses should support and respect the protection of internationally proclaimed human rights, and
2. Make sure that they are not complicit in human rights abuses
<i>Labor</i>
3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining
4. The elimination of all forms of forced and compulsory labor
5. The effective abolition of child labor, and
6. The elimination of discrimination in respect of employment and occupation
<i>Environment</i>
7. Businesses should support a precautionary approach to environmental challenges
8. Undertake initiatives to promote greater environmental responsibility, and
9. Encourage the development and diffusion of environmentally friendly technologies
<i>Anti-corruption</i>
10. Businesses should work against corruption in all its forms, including extortion and bribery

Reference: <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html>, accessed: July, 21, 2014

and actions, it relies on public accountability, transparency, and the enlightened self-interest of companies, labor, and civil society in order to pursue its principles (Enquist et al. 2006). Companies, NGOs, governments, academic institutions, and other stakeholder groups are the participants of the initiative (Runhaar and Lafferty 2009). More than 10,000 participants spread across 145 countries are involved in the Global Compact (as of July 2014, UNGC 2014b). Compared to its peers such as WBCSD, Prince of Wales International Leaders Business Forum, Global Reporting Initiative, and SA8000, the Global Compact with this feature is the world's largest voluntary network (Cetindamar and Husoy 2007; Rasche et al. 2013).

The Global Compact is not code of conduct for companies, but it is a universally accepted set of principle that presented for businesses to encourage aligning their operations and strategies with committed values. The initiative is a platform for governments, labor, and civil society organizations to establish a set of principles in the area of human rights, labor, environment, and anti-corruption and to discuss issues related to specified principles and through this way to learn and benefit from the interaction (Runhaar and Lafferty 2009). The principles could guide firms through operating in global responsibility.

## 16.4 UN Global Compact and Code of Conduct in Turkey

One of the most important roles of the UN Global Compact is providing a leadership platform for the development, implementation, and disclosure of responsible corporate policies and practices. It is the largest corporate sustainability initiative in the world, with over 12,000 signatories based in 145 countries (UNGC 2013a). Turkey held its first meeting in the Global Compact in Turkey in 2002. The Global Compact was launched by UNDP in partnership with the Turkish Confederation of Employer Associations (TISK) during the Istanbul Forum “Marching Towards 2023” conference. The initiative’s first phase was completed in Istanbul between 2005 and 2007 which focused on ways of enhancing cooperation between UN Turkey and all relevant partners, in particular, the private sector and multinational companies in support of Millennium Development Goals. There are 291 signatories across 32 sectors in Turkey. Although 21 Global Compact Turkey signatories were invited to the Dow Jones Sustainability Index for the assessment of 2013, one signatory has been listed on the Index. Among the top 15 tax-paying companies in 2013, 6 of them are members, and also 12 of the top 20 Conglomerate firms of Turkey are the member of the initiative (UNGC 2013b). Among the 291 signatories, there are only 121 business participants from Turkey in all sectors with an active COP (Communication on Progress) status (UNGC 2014c). Once a company embraces the Global Compact, the company’s Chief Executive Officer (or equivalent) commits the Compact and supports by the highest level Governance body of the organization. In addition to that, making the Global Compact and its principles an integral part of business strategy, day-to-day operations and organizational culture are expected from the company (UNGC 2014d). Companies also commit to issue an annual Communication on Progress (COP), a public disclosure to stakeholders (e.g., investors, consumers, civil society, governments) on progress made in implementing the ten principles of the UN Global Compact, and in supporting broader UN development goals (UNGC 2014e).

Table 16.2 summarizes the sectorial distribution of active COP status business participants (121) from Turkey. In light of the table general industries (17), construction and material (15), pharmaceuticals and biotechnology (14), support services (12), automobile (7) and media (6) constitute 59% of the active COP status participants. The longstanding firms in the Global Compact that operate in alternative energy signed the initiative in 2002. However, the newcomer company that located in the industrial transportation sector participated in 2014 and 20% of the active COP status firms participated in the initiative in 2014.

In this section, companies that participate in the Global Compact initiative from Turkey will be analyzed. As it is stated above, the Global Compact is not code of conduct for companies, but it is a universally accepted set of principle that presented for businesses to encourage aligning their operations and strategies with committed values. In the paper, therefore, we will try to find out whether the firms’ codes of conduct are based on this value. In line with the purpose of this article, the active COP

**Table 16.2** Sectorial distribution of active COP status business participants

Sector	<i>n</i>	Sector	<i>n</i>
Alternative energy	1	Household goods and home construction	3
Automobiles and parts	7	Industrial engineering	1
Banks	3	Industrial metals and mining	1
Beverages	3	Industrial transportation	4
Chemicals	5	Media	6
Construction and materials	15	Mobile telecommunications	1
Electricity	1	Non-life insurance	1
Electronic and electrical equipment	2	Oil and gas producer	1
Equity investment instruments	1	Personal goods	5
Financial services	4	Pharmaceuticals and biotechnology	14
Food producers	3	Real estate investment and services	2
General industrials	17	Software and computer services	1
General retailers	2	Support services	12
Health care equipment and services	1	Travel and leisure	4

status business participants' codes of conduct will be analyzed. For this purpose, the firms' corporate Web sites are examined to determine their code of conduct.

As it mentioned previously, the Global Compact principles are classified into four cornerstones: human rights, labor, environment, and anti-corruption. In the following section, the firms' code of conduct will be examined in line with the Global Compact principles.

### **16.4.1 Human Rights**

Supporting and respecting the protection of internationally proclaimed human rights and making sure that they are not complicit in human rights abuses is the principles that involved in human rights (UNGC 2014f).

It is expected for all firms to respect human rights, and it is also a general principle of law recognized by all nations. On the other hand, respecting human right is accepted as a firm's responsibility rather than a duty by existing corporate laws and stakeholders (Lauwo and Otusanya 2014). In line with this acceptance, some of the firms present human rights as a part of their corporate responsibility approach. For example, a firm that operates in household goods and home construction deliver its human right approach as stated below:

In a labour intensive industry such as furniture, qualified, trained and experienced human resources play key role in making profit and improvement in efficiency and safety....[and] our responsibility is to create healthy, safe and reliable physical environment and, besides, to have a social work environment that ensure an existence of worthy of human dignity and the highest level of working and human rights for all our workers....

In addition, a firm that operates in electricity industry acknowledges their responsibility toward society and humanity as a part of their code of conducts and operating principles.

As a company that signed the Global Compact, we endeavor to reach the highest level of welfare and happiness of society and humanity. The protection of democracy, human rights, the environment and natural resources, the consciousness of education and social responsibility and elimination of crime and corruption are so important for us....

### **16.4.2 Labor**

There are four principles that are claimed to represent acceptable labor conditions: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced and compulsory labor; the effective abolition of child labor; and the elimination of discrimination in respect of employment and occupation. The principles about labor are taken from the International Labour Organization's Declaration on Fundamental Principles and Rights at Work. It is aimed by the ILO to harness the support of the business community for these principles through the Global Compact. Upholding freedom of association and effective recognition of the right to collective bargaining and eliminating all forms of forced and compulsory labor are the principles of the labor part. Additionally, not employing child and eliminate discrimination in respect of employment are the part of labor-related principles (UNGC 2014g).

Employees were one of the important assets of organizations, and especially in service industry, it is inevitable for any firms to attain competitive advantage, growth, and expansion. Companies that respect basic social norms and legal regulations and show any particular commitment to their stakeholders gain reputational advantages, and the firms make business environment a pleasant one are more productive, more profitable, and less likely to be affected by industrial disputes (Muñoz, et al. 2008; Watson 2002). These corporations could ensure that regulations on labor, human rights, and environment are implemented and respected. The implementations create not only economic outcome but also the potential of better social conditions, through increased investment, increased trade, and spill-over of activities that corporations undertake to address social issues (Buhmann 2006). With respect to labor, the Global Compact participants from Turkey admit that attach importance to human. The understanding is reflected on companies' code of conduct. A company operated in construction stated that:

human is the most important assets for the company. Any discrimination of gender, language, religion, race or political view should be eliminated in both domestic and international business process. [...] The company employees work under the guarantee of qualified healthy and safe workplace environment. The company aims for zero occupational accident.

In addition, an automotive company clarifies its working philosophy as below:

Is to work with a team who is suitable to our company values honest, dependable, respectful to people, transparent, constructive, participating, innovative, open minded and for each member to feel the feelings of joy- happiness- peace - success and being a part of- while working.

The company also admits that each employee is the most being of the company. Therefore safety is so important for them.

each employee as the most important being of our company. Therefore, our basic goal is to 'secure the return of each company employee to home and to his/her family in a fit and healthy condition.

In line with this understanding health and safety, working hours, salaries, freedom to organize and signing collective labor contracts, children workers, forced labor and abuse and discrimination are the areas the company has code of conduct. The codes of conduct are stated below:

#### Health and Safety

We provide a work environment for all of our employees that may be adopted as best practice on the issue in the sector above the standards of safe, healthy and valid work safety and health.

#### Working Hours

We abide by the laws on work hours.

#### Salaries

while determining the salaries and social rights of our employees, we give priority to the formation of conditions that will provide their welfare and happiness, we keep in mind the market conditions, and provide conditions that are suitable to labor laws and collective labor agreements.

#### Freedom to Organize and Signing Collective Labor Contracts

We approve and respect our employees' right to organize and sign a collective labor agreement. We are in creative collaboration with their chosen representatives.

#### Children Workers

We do not employ workers that are under the age of 16 other than the training and apprenticeship programs approved by government agencies, we absolutely do not employ children workers and we also make sure that our business partners who enter our premises for temporary activities obey the relevant rule.

#### Forced Labor

We do not support forced labor. We absolutely do not allow disciplinary precautions based on physical violence or torture.

#### Abuse and Discrimination

We do not allow discrimination among our employees based on race, language, religion, color, gender, age, ethnicity or national roots.

### 16.4.3 *Environment*

There are three principles related to environment in the Global Compact: Businesses should support a precautionary approach to environmental challenges; undertake initiatives to promote greater environmental responsibility; and encourage the development and diffusion of environmentally friendly technologies. The principles are drawn from a Declaration of Principles and an International Action Plan, namely Agenda 21. The declaration also stems from the United Nations Conference on Environment and Development, the Earth Summit, held in Rio de Janeiro in 1992. The environmental principles are entry point for firms to consider the key environmental challenges. Especially, the principles encourage business to deal with significant environmental degradation issues by researching, innovating, cooperating, educating and self-regulating (UNGC 2014h). The limits of environmental resources prevent the wealth of both existing and coming generations and companies' activities could produce harmful environmental impacts (Cabezas et al. 2004; Setthasakko 2009). Loss of biodiversity and long-term damage to ecosystems, pollution of the atmosphere and the consequences of climate change, damage to aquatic ecosystems, land degradation, the impacts of chemicals use and disposal, waste production, and depletion of non-renewable resources are the key environmental challenges (UNGC 2014h). When the impacts are considered by the companies and its stakeholders, there could be a possibility to make the activities more sustainable way. According to detailed thematic analysis of the Codes of Ethics of the world's 200 largest corporations, companies are featured environmental issues more than in past (Stohl et al. 2009). With respect to environment, a participant company which is chemical producer in Turkey, admit that it *respect human health and environment*. In line with its sustainability approach, the company also has an environmental policy which is below:

As a company that produces chemicals and that designs and installs chemical facilities, we adopts the following environmental principles to make the world a better place to live in:

- We take all necessary precautions to prevent environmental pollution.
- In our operations, we give priority to and apply environment-friendly technologies that are continuously developing.
- We abide by legal and other requirements. We prioritize sensitivity toward the environment as a part of our awareness on our responsibilities for the nature and the society.
- We cooperate with our suppliers and customers and contribute to increasing their environmental sensitivities.
- We get engaged in works towards developing environmental awareness of the society.
- We share and keep our environmental works transparent for review by the society.

A company that operates in construction and materials introduces its business manner as below:

... Based on respect to humans and the nature, we are heading to the future with innovative efforts.

Solidarity, resoluteness, rationalism, improvement, and respect are their core values of the company and as a part of its last value (respect), the company “*respect nature and all the living creatures.*” It could be interpreted that to actualize the values and the Global Compact principles, the company determined a health and safety policy. Details of the policy as stated as below:

- Complies with all current laws and regulations and implements the programs and procedures that would ensure this to be the case.
- Aims to accept legal requirements as the minimum level to be met and exceed them when identifying the quality standards with respect to environment, health, and occupational safety.
- Minimizes risks by creating safe work environments for its staff utilizing cutting-edge technology.
- Prepares disaster management and improvement plans in order to be ready in urgent cases.
- Minimizes the amount and the danger of the waste produced by taking necessary measures in order to prevent disposing hazardous materials in nature for the protection of the environment and the people.
- Utilizes opportunities to continuously improve environmental, health, and occupational health policies.
- Informs staff, suppliers, customers, and investor partners about developments, asks for their contribution to the achievement of objectives, and supports them to achieve their own objectives.
- Measures and improves performance and shares it with business and investor partners.

Another participant firm that was established in order to produce corporate promotional so many kinds of plastic materials took a part subscribing the Global Compact. The firm proposes that they became participant as an indicator of concepts about its environmental and social aspects. Although the company does not indicate any specific code of conducts, it's all production of the company is eco-friendly. In its sustainability report, the company admitted that “*nowadays, as the environmental problems, especially the climate change, become more evident and begin to affect our living conditions socially, economically, and environmentally, the company X chose to be a part of the solution, not the problem.*” The firms also explain that “*considering the full life cycle the final products, all production activities of firm evaluated within the light industrial production, create environmental impact on a minimal level.*”

#### **16.4.4 Anti-corruption**

According to anti-corruption principle which was added on June 24, 2004, during the UN Global Compact Leaders Summit, businesses should work against corruption in all its forms, including extortion and bribery. Corruption is not indulgently considered since it is inherently wrong and creates unpleasant results for the business and society. Legal and reputational risks, financial costs, knowing as no clean, exposing blackmail and security risks, and having a perception that the one who cheats will be cheated against are the some of the undesired side effect



of corruption (UNGC 2014i). The UN Global Compact suggests three elements to fight corruption and implement the tenth principle. The first element is internal. It is a first and basic step; introduce anti-corruption policies and programs within their organizations and their business operations. The second element is external and the element includes reporting on the work against corruption in the annual Communication on Progress; and sharing experiences and best practices through the submission of examples and case stories. The last element is collective and it refers to join forces with industry peers and with other stakeholders (UNGC 2014i). Corruption creates negative effects on economic growth, business development, public expenditures, and domestic and foreign investment and the effect of corruption on driving firms to the unofficial economy (Kaufmann and Wei 1999). For that reasons, actualizing anti-corruption principles toward code of conduct is important to create corruption-free economic systems. Among the participant from Turkey, a construction company's code of conduct about anti-corruption is below:

- It is absolutely unacceptable to accept and offer or to instigate or to promise a bribe.
- We do not commit a fraud, and if it occurs we will sever our relations immediately with those.
- We fight against money laundering and never allow such actions to do.
- We adopt principles of fair and free competition while respecting company's interest.

In addition, a holding states that:

Our motto is to always act fairly in all our relations with the perspective of ensuring mutual benefit, to act with good faith and understanding in accordance with the laws and ethical principles.

In line with this, the group determines employee and external relations within the group, the code of ethics mandatory for employees, occupational health and safety, prohibition from political activity, and implementation principles of the code of ethics and business conduct. The code of ethics mandatory for employees could be classified into two groups: Asset and information management, and avoiding conflicts of interest. The first group involves intellectual property rights, information management, security and crisis management, and confidentiality. The second group includes refraining from transactions with self-interest or from related party transactions, representation and participation in events, receiving and giving gifts, doing business with the group after termination of employment, and insider trading.

## 16.5 Conclusion

This paper analyzes if there is any common ground or differences between the companies code of conduct and the UN global compact principles. For the purpose, companies that participate in the Global Compact initiative from Turkey are analyzed.

The United Nations Global Compact initiative is a universally accepted set of principle that presented for businesses and non-business. The aim behind the principles is encouraging businesses to align their operations and strategies with committed values. Not only business but also governments, labor, civil society organizations could be part of this initiative. The principles are not code of conduct; it could be accepted as a frame to persuade companies to perform in the direction of globally shared values.

The unethical practices of firms create negative organizational results. Code of conduct refers to written documents which are used as a managerial medium that intended to impact employee behavior by making explicit statements to desired values. From a different point of view, code of conducts is written documents which are defined to prevent the negative results and enhance corporate reputation and brand image. For this purpose, the codes could be used to send right message to about good business practices, internally and externally.

In this study, it is tried to analyze if there is any common ground or differences between the companies' code of conduct and the UN global compact principles. The information related to code of conducts of companies is gathered from their Web sites.

General industries, construction and material, pharmaceuticals and biotechnology, support services, automobile and media constitute 59% of the active COP status participants from Turkey. The longstanding firms in the Global Compact that operate in alternative energy signed the initiative in 2002. However, the newcomer company that located in the industrial transportation sector participated in 2014 and 20% of the active COP status firms participated in the initiative in 2014. The research result indicates that firms have different approaches in setting up code of conduct. There is generally common ground between companies' code of conduct and the UN Global Compact principles. Some of the companies prefer to set up their own code of conduct in parallel with the UN Global Compact principles. However, some firms only disclose that they are the participant of the initiative and adopt the principles and there is not any expression about firm's code of conduct. On the other hand, it is possible to observe trace of the some of the UN Global Compact principles effects on firms' code of conducts. As it is stated above, The Universal Declaration of Human Rights (1948); the Rio Declaration on Environment and Development (1992); the International Labor Organization's Fundamental Principles and Rights at Work (1998); and the UN Convention against Corruption (2003) are the source of where the principles come from (Williams 2007; Ruggie 2001; Kell and Ruggie 1999). Although each of the documents involves different issue, all of them intrinsically aim to promote human life. For managers, it is important to remember that a firm's *raison d'être* is to meet the needs and expectations of human, and consideration of social values, such as the UN Global Compact, has become more vital than ever, since behaving socially responsible manner is the issues that stakeholders are curious about.

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# Chapter 17

## Ethical Evaluation of the Duty to Report Patients Crimes in Turkish Psychiatric Practice



Okan Çalıyurt

### 17.1 Introduction

Psychiatry is the branch of medicine focusing on the mental disorders. Psychiatry deals with the etiology, diagnosis, treatment, rehabilitation or prevention of mental, emotional and behavioral disorders. Psychiatrists are medical doctors who graduate from medical school and take residency training in psychiatry. Ethical problems can arise in many areas of psychiatry, for example, involuntary treatment of psychiatric patients, confidentiality, informing patients about their diagnosis, or psychiatric studies. Besides these, ethical issues take place in forensic psychiatric cases and treatment interventions with pharmacotherapies or psychotherapies (Arboleda-Florez 2006).

Since psychiatry is a part of the medical field, medical ethics is involved in the practice of psychiatry. There are many ethical problems in medicine today. Along with the developments in technology and the progress of medicine, ethical problems can be increased or changed. But on the other hand, many of the ethical issues are not related to the progress of medicine. Patient rights are the core of medical ethics (Arda 1995). Declaration of Lisbon by World Medical Association reveals patients rights. Right to medical care of good quality, right to freedom of choice, right to self-determination, the unconscious patient, the legally incompetent patient, procedures against the patient's will, right to information, right to confidentiality, right to Health Education, right to dignity, and right to religious assistance are covered in this declaration (Winton 1982).

For biomedical research on humans, The World Medical Association has developed the Declaration of Helsinki. This declaration is probably the most important ethical codes related to the medical studies involving human subjects (Enqueslassie 2014). Because the medical progress depends on research to be done on humans the guidelines have been developed for physicians by World Medical Association. The main objective is the protection of human subjects. But it still contains controversial issues (Malik and Foster 2016).

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There are four general principles of medical ethics (Kennelly 2011). These are Autonomy, Beneficence, Nonmaleficence, and Justice. People are free to deny and approve all treatments, initiatives that will be applied to them. These decisions may not always be in the best interest of the patient but should be respected. All healthcare professionals should work for the well-being of the patient. Efforts should first be made so that patients are not harmed. The implementation of the treatments or the distribution of resources should be as fair as possible.

## 17.2 Ethical Issues in Psychiatry

All medical doctors must practice their profession in line with medical ethics codes. Similarly, psychiatrists must follow medical ethics rules, but they also have to cope with the different ethical problems brought about by psychiatry. Developments in both general medicine and psychiatry increase the need for ethics. Ethics is very important, not just doctors who are new to their profession or inexperienced doctors, but also all doctors and even very experienced ones. Psychiatry is a fairly new branch of medicine. Psychiatry differs from other medical specialties in many areas. Therapeutic relationship has an important role and psychotherapeutic treatments to be applied to the patients directly affect the individual's self. The uncertainty between normal and abnormal and the fact that psychiatric diagnoses are not based on etiologic bases make psychiatric treatments controversial.

In the following paragraphs, some psychiatric ethical problems will be listed.

We do not know exactly how the brain works and underlying mechanisms of psychiatric disorders yet. But on the other hand, psychiatrists diagnosing millions of patients with psychiatric diagnoses all over the world. Psychiatric diagnosis brings with it a heavy burden and stigmatization. After these diagnoses, treatments are started and generally long-term drug treatments can be preferred by psychiatrists.

Serious ethical problems can arise in psychiatric research. Psychiatric research is aimed to understand the psychiatric diseases and to improve the most effective treatments in their treatment. But especially in psychiatric research, informed consent, privacy, and the benefit to the patient can become controversial (Tsao et al. 2008).

Dual role dilemma is a major problem in psychiatry (Robertson and Walter 2008). Psychiatrists are expected to act in the best interest of their patients. However, from time to time, conflicts with society or other health care workers may arise. As a result, it may not be possible to take all of the steps for the patient's favor.

Most of the psychiatric patients make direct application to hospitals and also becomes discharged from the hospital voluntarily (Robertson and Walter 2007). But, it can enable the psychiatric patients to be brought to the hospital at the request of family or relatives or court decision. Sudden aggression or problems experienced in emergency service can also be ended by involuntary admission. Involuntary psychiatric treatment or hospitalization is one of the most important ethical problems in psychiatric practice. The individual harm that may occur with the cause of illness in those with psychiatric disorders or the risk that may arise against nearby individuals

then involuntary treatment may require. On the other hand, it is possible to prevent suicides which are an important cause of death and to minimize the damage to the environment by involuntary treatment. This dilemma makes it inevitable to discuss a major ethical problem in psychiatry. Psychiatric patients can become victims in the system.

In the practice of psychiatry, doctors demand the best for their patients and they work for it. Psychiatric patients should know what their illness is, the course of the illness and the treatment options. They should take part in the decisions of the treatments to be done to them. In this process, it is essential that the patient is informed and gave consent the period from diagnosis to the end of treatment. The patient must be offered a choice. And thus patient may take part in decision-making processes related to him or her. Patients with a psychiatric disorder may not be able to understand or approve treatments to be given to them. Receiving informed consent may not be appropriate for certain psychiatric disorders (Amer 2013).

Beyond involuntary treatment or hospitalization, some psychiatric patients receive restrictive treatments. In this way, the safety of dangerous patients can be ensured and their harm to themselves and their environment can be prevented. During restraint, forced medication may also administer. These practices must be appropriate to human rights. Restrictive treatments should not be punitive practices (Segal et al. 2017). These areas are places where ethical problems arise.

Confidentiality is one of the most important building blocks of psychiatry (Lindenthal and Thomas 1992). All communication between a psychiatric patient and a psychiatrist is confidential and should remain so until the patient has given written approval. Otherwise, in case of the court decision, psychiatrists cannot comply with the confidentiality rule. However, it is possible for psychiatrists to experience significant conflict if the patient gives suicidal or life-threatening information.

### **17.3 Duty to Warn and Duty to Protect in Psychiatry**

In this section, the issue of confidentiality and privacy, which creates a debate in the field of psychiatric ethics in Turkey, will be discussed. Respecting the privacy and confidentiality of patients since ancient times is considered an important responsibility. In the Hippocratic oath of ancient Greek, respect to confidentiality is written in these words: "What I may see or hear in the course of the treatment or even outside of the treatment in regard to the life of men, which on no account one must spread abroad, I will keep to myself, holding such things shameful to be spoken about." This ethical rule is almost universally accepted today as well. In most countries, the law guarantees the protection of the confidentiality of patients. World Medical Association Declaration of Geneva states very similar to the Hippocratic oath "I will respect the secrets that are confided in me, even after the patient has died." In the medical ethics, doctors are obliged to keep all confidential information of their patients and they can only share them with the patients' permission (Wiesing and Parsa-Parsi 2016).

Psychiatrists have to treat aggressive and dangerous patients. It is not always possible to control the violent patient. The violence that these inadequately treated patients can create in society is a major area of conflict. Psychiatrists are under legal responsibility in such cases. Mental disorders and its relationship with criminal responsibility is an important forensic psychiatric issue. Psychiatric disorders can be found in close to one-third of the prisoners (Sepehrmanesh et al. 2014). Alcohol and substance use disorders are psychiatric disorders and linked to violence in some cases.

On the other hand, it is necessary to evaluate this data carefully. Mental disorder and crime relationship are controversial. Most of the prisoners in prisons are normal individuals without psychiatric disorders. Of course, schizophrenic individuals can also commit crimes. But schizophrenic patients can become victims of crimes rather than criminal. On the other hand, criminalization of those with psychiatric disorders is an important mental health problem. This approach places psychiatric patients as criminals in the legal system rather than in the mental health system. The crime associated with psychiatric patients negatively affects their evaluation. Society, perceive psychiatric patients as dangerous and prone to crime. Doubtful insanity defense cases affect the accurate medical assessment of psychiatric patients. As a result, the punishment of patients for community safety can be used instead of psychiatric treatment (Allnutt et al. 2007).

Some psychiatric patients carry a potential to harm themselves or others. These patients are high-risk clinical psychiatric emergencies. In case a psychiatric patient threatens harm to another person a very serious conflict situation arises. In such a case, duty to warn and duty to protect patients and endangered other people should be considered first. Then, it may be necessary to choose between respecting privacy and confidentiality and doing a behaving conscientiously. There are exceptional cases of this kind both in the law and in the ethics. In general medicine, some infectious diseases or sexually transmitted diseases are reported to the authorities. Similarly, the disclosure of confidential information shared by psychiatrists can be discussed. New standards and ethical codes have been established for duty to warn and duty to protect after the Tarasoff case in 1976 (Melamed et al. 2011).

The case of Tarasoff v. Regents of the University of California: Prosenjit Poddar and Tatiana Tarasoff had been students at the University of California at Berkeley. Poddar killed Tarasoff in 1969. They met in a dance class and continued to meet, but Tarasoff did not want to maintain the relationship seriously. Poddar was depressed and was treated by the staff psychologist. Poddar confided to a psychologist that he was going to kill Tarasoff. Psychologist Dr. Moore informed the campus police that Poddar was dangerous. The police caught Poddar but released him for not finding him dangerous. Poddar stopped seeing his psychologist. Two months later Poddar went to Tarasoff's house and stabbed her to death. Tarasoff's parents sued Moore and other employees of the University. The Tarasoff I and Tarasoff II cases were decided by the California Supreme Court in 1974 and 1976, respectively. In Tarasoff I, the California Supreme Court stated that therapists have a duty to warn others who are in foreseeable danger from the therapists' patients and Tarasoff II, court stated that



the therapist has a duty to “use reasonable care to protect the intended victim against such danger” (Walcott et al. 2001).

Thanks to the case, the protection of third parties from possible violence has started to be provided legally. Clinicians have been put forward as a protection duty. It has become an important responsibility to determine how dangerous the patient may be. This process actually requires a serious forensic psychiatric evaluation. It is difficult to make this assessment for every patient. It is very difficult for each evaluation to be successful. Therefore, achieving an excellent result, preventing violence and protecting third parties with success cannot be realistic.

Confidentiality is fundamental in the practice of psychiatry. Confidentiality is also included in the psychiatric codes of ethics. As with this case, privacy breaches can occur in some serious situations. On the other hand, each case is assessed within its scope, and the challenges of the difficult cases and the clinicians’ individual approaches complicate the picture. In conclusion, it would be appropriate for clinicians to reach their conclusions with ethical evaluation (Kleinman 1993).

## **17.4 Discussion and the Duty to Report Patients’ Imminent and Past Crimes in Psychiatry**

The protection of the third parties started to be provided by Tarasoff case. The other side of this problem is directly related to the patient and indirectly to the clinician. This problem is the reporting of the crime to the authorities. During the therapeutic relationship, the doctor can learn that the patient had previously committed a crime or was planning a crime. The protection of potential victims is obviously important. However, reporting this crime is an important debate. Especially, it becomes more important if reporting this crime is imperative as a law. According to the Madrid declaration, it is the duty of the psychiatrist to protect the patient privacy and confidentiality (Sher et al. 2014). It also forms the basis of the relationship of respect and trust between the patient and the doctor. It can even be a part of the success of treatment that confidentiality between patient and doctor has been considered mandatory to successful treatment. Therefore, psychiatrists must adhere ethically to patient privacy and confidentiality. Otherwise, they will commit an ethical breach and adversely affect treatment success.

Not reporting a crime is not a criminal offense in many countries. In some countries, certain type people need to report a crime. In some places, special crimes such as child abuse must be reported. Relevant laws define the framework of this process.

The current Turkish penal code in Turkey began to be implemented in 2005. Many changes are included and updated with this version. In this new version, laws such as experimentation on human, organ and tissue trading and genital examination have been added (Turkey et al. 2007). One important regulation is related to medical practice and directly affects the practice of psychiatry. In the title of “Failure by a Member of the Medical Profession to Report an Offence” article 280 states that (1)

Any member of the medical profession who fails to report of an offense, or delays in reporting such offense, to the relevant authority after becoming aware, in the course of his duty, of any evidence demonstrating that a crime may have been committed shall be sentenced to a penalty of imprisonment for a term up to one year. (2) A member of the medical profession shall include physicians, dentists, pharmacists, midwives, nurses, and other persons who provide health services. Patients often share with their psychiatrists the events they are experiencing, the things they hide, or the intimate subjects. From time to time, they also share crimes that they have committed or planned to commit. This law is mainly affecting psychiatrists. For this reason, psychiatrists can be brought to court if they do not report the crime, because they expose society to danger.

The healthcare professional is obliged to report the crime if he or she clearly understands that the crime has been committed or if there are traces of suspicion in this area. Hence, even if there is no strong evidence, the only doubt is enough. Article 280 places the duty of reporting a crime before the treatment of the patient (Buken et al. 2006; Izgi and Oguz 2010). When the clinician believes that a crime has been committed, there may be two options. Either the patient is the victim or the patient is the perpetrator. In some cases, the victim may want to be informed of the crime but sometimes a patient may choose to remain secret. On the other hand, a patient who committed a crime will not want this situation to be reported. The fact that this law is also known by patients will be a major problem in the doctor-patient relationship. People who have previously committed crimes or plan to commit a crime, or who have been victims of crime but do not want it to be known, will not share these issues with their psychiatrist. The patient-doctor relationship will be negatively affected. Patients will be cautious in their sharing; they will be in doubt about their relationship with their doctor. Due to the lack of information and the suspicious approach, full evaluation of the patient will not be possible. This process may lead to inadequate diagnosis and treatment failure.

If the health profession is a public official, the situation becomes complicated. Article 279 defines the situation where public officials to report a crime. The article 279 titled with "Failure by a Public Officer to Report an Offence" and states "(1) Any public officer who fails to report of an offense (which requires a public investigation and prosecution), or delays in reporting such offense, to the relevant authority, after becoming aware of such offense in the course of his duty, shall be sentenced to a penalty of imprisonment for a term of six months to two years. (2) Where the offense is committed by a judicial law enforcement officer, the penalty to be imposed according to aforementioned paragraph shall be increased by one half." The controversial issue here is that if the health worker is a government official, the application of which law will be correct Article 279 is more extensive than the article 280, even if the complainant does not complain, and the public officer is obliged to report to the authorities.

Many negative aspects of this law may arise. Patients will have problems in various areas. If they know that the doctors will inform them of the authorities, the patients' perspective on psychiatry will change. Perhaps the main problem is that these patients would never go to psychiatry, or they will not share with the doctor any details they

know are criminal. This can be interpreted as a violation of the right of patients to receive health care because if there is not enough information about the patient, diagnosis, and treatment problems will come along with it. As a result, patients may be worsened and individual or environmental adverse effects may be expected. Thus, the right to receive health care may not a priority or may never to be used by patients. Finally, a health care service would not be provided to patients as it should be. In fact, it appears that patients are vulnerable to privacy violations and criminal reporting behaviors. In one study, patients were shown to be anxious and sensitive about their privacy. They are reported to have limited legal knowledge of privacy rights. The value of confidentiality and privacy education is emphasized (Schmid et al. 1983).

On the other hand, this process also affects doctors. Since the patients will need to share their experiences, doctors will be in constant conflict. Learning that a crime has been committed will ruin the therapeutic relationship. It will be a conflict between helping the patient and do his legal duty. As a result, if a criminal report is filed against a patient to the authorities, the patient will not apply to the doctor again and will not be able to continue treatment.

The rules of professional ethics in psychiatry have been determined by the Turkish Psychiatric Association. Article 14 is related to the right to treatment and states “The psychiatrist should not interfere or delay the treatment of a person for any reason.” Obviously, sharing of possible criminal information about patients will have an effect on preventing or delaying psychiatric treatment. Some patients will have problems with diagnosis and treatment with the reason for hiding and sharing limited information about themselves. A psychiatrist may not establish a healthy therapeutic relationship with the patient because of the lack of confidence in the patient. For reasons of lack of trust, patients who can not come to the psychiatrist will not be able to use their right to be treated from the very beginning.

Article six sets the obligation to keep secrets and states that “All information about any psychiatric examination and patient under treatment should be kept confidential under the patient-physician principles.” This information can only be shared with the family for the purpose of protecting and improving the mental health of the patient, with the approval of the patient and can be used for consultation with other specialist physicians. Psychiatrists should not disclose information about their patients in terms of their political, managerial, mediatic or material interests, academic, professional or personal interests unless their patients are concerned with situations such as personal rights, the right to treatment, the wrong professional practices. If the information gained in the patient-physician relationship is deemed necessary, he may establish a reason to withdraw from the testimony or expertise in court. When specific information about the psychological structure, such as the private life of the person, special relationships, defense mechanisms, is requested, it depends on the person’s clear consent. The psychiatrist should know that even if the patient has given permission, he or she should not explain such information if it is not helpful to the patient. A privacy rule may be violated if the possibility of serious physical, mental or economic harm to the patient or his or her environment. The psychiatrist can not give any information to the other person or any organization concerning the identification of the

patient or the prediction of possible behavior. In the case of statutory obligations, the doctor's report preparation does not mean the disclosure of the profession secret.”

As can be seen, the ethical rules published by the Turkish Psychiatric Association conflict with the above-mentioned articles of the Turkish Criminal Code. If data sharing with an institution such as a court is to be reported, it may be done after the patient's approval. It is even emphasized that having this information may be the reason for withdrawing from the testimony in court.

Members of health care professions should be able to provide medical services without conflict between their ethical values and legal rules. A survey was conducted on the propensity of mental health professionals to report past crimes (Goldman and Gutheil 1994). Results showed that only 11% mental health professionals believed they had a reporting duty. This research shows that clinicians pay more attention to patient privacy. On the other hand, they seem to be reluctant to fulfill their legal obligations.

But it is becoming controversial not to report a crime when you are out of the medical field. Generally, individuals tend to not report a crime when they are witnesses or when they learn that a crime has been committed. Legally, there is no obligation to report the committed crime. In one survey, college students and individuals in the community were questioned about their opinions about reporting a crime. The results showed that most of the participants reported that for the majority of the offenses failed to report crimes would be punishable and that it would be appropriate to increase the punishment if the crime was more serious (Veneziano and Veneziano 2000).

As a result, the right to live a healthy life of those with psychiatric disorders must be in accordance with current psychiatric research and scientific developments in the field of psychiatry; on the other hand, these processes should not conflict with the relevant legal regulations. In this regard, it may be possible for health professionals to stay away from ethical conflicts while helping those with psychiatric disorders; psychiatric patients can be provided with the best treatment.

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# Author Index

## A

Ali, Hasani Mohd, [257](#)  
Akpınar, Özgür, [77](#)

## B

Batrancea, Ioan, [227](#)  
Batrancea, Larissa, [227](#)  
Bian, Jing, [207](#)

## C

Çalyurt, Okan, [311](#)  
Çelikdemir, Neşe Çoban, [63](#)

## D

Donmaz, Ayşegül, [153](#)

## E

Elçi, Meral, [77](#)  
Erolu, Nevber Zeynep, [97](#)  
Esen, Emel, [13](#)

## F

Faridah Abdul Jabbar, Siti, [257](#)  
Feng, Dongning, [3](#)

## J

Jakupović, Sanel, [165](#)  
Jalil, Faridah, [257](#)

## K

Karabay, Melisa Erdilek, [63](#), [77](#)  
Kaur, Harpreet, [273](#)

## L

Lu, Yuan, [115](#), [131](#)

## M

Marchione, Frank, [207](#)  
Muhammaddun Mohamed, Zakiah, [257](#)

## N

Nichita, Anca, [227](#)

## O

Ozsozgun Caliskan, Arzu, [295](#)

## P

Pamukcu, Ayse, [97](#)

## S

Sayil, Emine Mediha, [23](#)  
Sun, Hong-you, [131](#)  
Šupuković, Vedran, [165](#)

## T

Tunca Çalyurt, Kıymet, [41](#)

## V

Vujnović-Gligorić, Bogdana, [165](#)

## Y

Yang, Fan, [3](#)

## Z

Zheng, Ying, [115](#)

# Subject Index

## A

Accounting, 43, 54, 58, 63, 66, 69, 70, 72, 73, 97, 99, 100, 102, 103, 112, 177, 180  
Accounting ethics, 63, 64, 69, 70, 72, 97–100, 111  
Accounting professionals, 70, 238  
Accounting scandals, 70  
Analysis of variance, 88–90  
Arthur Anderson, 66

## B

Banking ethics code, 244  
Body of Licensed Accountants And Expert Accountants in Romania (CECCAR), 237, 238, 250  
Business, 6, 7, 9, 11, 23, 41, 42, 54, 58, 63–66, 69, 71, 72, 77, 84, 91, 97, 106, 109, 125, 138, 141, 156, 168, 169, 171, 175, 176, 179, 181, 182, 212, 214, 222, 227, 229, 230, 232–234, 238, 243, 245, 250, 258, 259, 262, 263, 269, 282, 283, 296–298, 307  
Business ethics, 23, 34, 42, 63–65, 67, 69, 72, 77, 82, 83, 91, 92, 162, 166–168, 174, 175, 199, 208, 213, 228–230, 232, 234, 237, 244–247, 249  
Business Ethics Index (BEI), 230–233, 245

## C

Chinese overseas investment, 207, 209–211, 213–215, 217, 221  
Commercial translation, 3, 5, 11  
Competition, 55, 63, 176, 182, 189, 243, 246  
Competitive advantage, 77, 167, 171, 199, 302

Compliance, 67, 81, 97, 110, 112, 136, 155, 174, 179, 180, 190, 218, 235, 237, 240, 249  
Conformity, 55, 245, 247, 248, 262  
Contingency plans, 216  
Corporate conduct, 233  
Corporate ethical standards, 71  
Corporate leadership, 79  
Corporate philanthropy, 71  
Corporate scandals, 66, 70, 296  
Corporate Social Responsibility (CSR), 65–67, 71, 72, 161, 218, 245

## D

Dispute resolution, 265, 266  
Due diligence, 202, 219–221, 276  
Duncan test, 89–91

## E

Employee, 15–19, 34, 64, 67, 69, 71, 72, 77, 80, 82, 84, 86, 89–92, 140, 166, 167, 175, 179–182, 193, 195, 202, 218, 228–230, 233, 234, 238, 242, 244, 246–248, 250, 267–269, 295, 297, 302, 306  
Employee attitude, 82  
Employee unethical behavior, 83, 86, 87, 89, 91, 92, 167  
Enforced, 235  
Enron, 17, 42, 66, 67, 295, 296  
Environment protection, 211, 233  
Environmental impacts, 215, 218, 304  
Equality, 175, 241

- Ethical behavior, 25, 34, 63, 65, 68, 71, 82, 84, 161, 173, 174, 183, 202, 230, 232, 234, 245, 246, 249, 297, 298
- Ethical climate, 16, 64, 68, 72, 81, 267
- Ethical codes, 54, 72, 77, 80, 83, 295, 311, 314
- Ethical commitment, 79
- Ethical conduct, 63, 67, 82, 171, 180, 269
- Ethical context, 80, 82
- Ethical culture, 64, 69, 77–80, 82–85, 91, 92, 104
- Ethical decision, 11, 67, 68, 70, 168
- Ethical decision making, 67, 68, 79
- Ethical dilemma, 42, 83, 162, 168, 258
- Ethical environment, 64
- Ethical leadership, 72
- Ethical obligations, 242
- Ethical perception, 80, 92
- Ethical responsibility, 3, 11, 16, 71, 233
- Ethical standard, 66, 69, 70, 72, 79, 82, 112, 166, 178, 179, 183, 238, 295
- Ethical value, 68, 69, 80–82, 92, 98, 110, 156, 170, 173, 174, 177, 183, 187, 188, 190, 318
- Ethics, 4, 6, 23, 34, 54, 56, 63, 66, 71, 72, 85, 91, 98, 126, 156, 162, 166, 168, 170, 174, 179, 180, 183, 186, 188, 190, 228, 238, 246, 248–250, 295, 306, 314
- Ethics code awareness, 81
- Ethics committee, 72, 169, 183, 249
- Ethics pays, 65
- F**
- Financial sector, 78, 91, 201
- Financial service, 78, 83, 229, 301
- G**
- Green credit, 217
- H**
- Hierarchy Of CSR, 71
- I**
- Industrial guidelines, 208, 217
- Insurance, 49, 52, 83, 84, 92, 177
- Insurance Association of Turkey (TSB), 84
- Insurance industry, 78
- Integrity, 5, 71, 82, 156, 167, 197, 240, 243, 250
- Internal control, 54, 154
- International Accounting Business Standards, 70
- Islam, 257, 258, 260, 263–266, 269
- L**
- Lasting interest, 210
- Legal regime, 208, 211
- Local communities, 215, 216, 220, 221
- M**
- Management, 16, 18, 41, 58, 63, 66, 72, 77, 84, 107, 109, 110, 120, 171, 179, 213, 217, 248, 269
- Managerial ethics, 63, 65–67, 72
- Managerial unethical behaviour, 83
- Mining, 218, 219
- Ministry Of Commerce (MOFCOM), 212, 215
- Moral behaviors, 68, 99, 166
- Morality, 41, 98, 105, 125, 145, 166, 169, 173, 174, 178, 188, 196, 199, 228, 232, 264
- Moral objectivism, 246
- N**
- National Development And Reform Commission (NDRC), 212
- Noncompliance, 237
- O**
- Occupational health and safety, 219, 306
- Organizational Commitment (OC), 14, 77, 78, 80–82, 85, 86, 88, 91, 92
- Organizational ethics, 67, 83, 91
- P**
- Parmalat, 67, 295, 296
- Precepts, 228, 238, 240, 250
- Private sector, 115, 243, 250, 298, 300
- Professional deontology, 233
- R**
- Rebranding, 9, 10
- Regression analysis, 86
- Reinsurance company, 84
- Reputation, 10, 13, 56, 63, 69, 77, 79, 85, 105, 110, 116, 133, 167, 199, 227, 236, 307
- Romanian market, 228, 237, 238, 243–245, 247, 248, 250
- S**
- Social Darwinism, 246
- Social responsibilities, 41, 56, 63–65, 67, 71, 98, 218, 228, 236, 245
- Stages of the compliance process, 235
- State Administration of Foreign Exchange (SAFE), 212
- Strategic decision-making process, 69
- Supply chain, 218–221



**T**

Tax administration, 241–243  
Tax authorities, 235, 236, 249  
Tax avoidance, 236, 249  
Tax behavior, 234, 235, 237  
Tax evasion, 70, 99, 112, 236, 237, 249  
Thales the Milesian, 228  
Translation theory, 4  
Transparency, 109, 177, 179, 203, 214, 218,  
220, 241, 250, 299  
Transparency International Romania (TI-RO),  
247, 250  
Trompenaars, 230  
Trust, 54, 69, 70, 92, 99, 101, 106, 109, 146,  
154, 161, 163, 172, 173, 175, 190, 196,  
233, 234, 243, 249, 262–264, 315

Trustworthiness, 97, 99, 227, 234, 249

T-test analysis, 89

**U**

Unethical behavior, 15, 63, 64, 66, 68, 70,  
82–84, 99, 100, 112, 176, 195, 295, 297  
Unethical culture, 66, 78, 79, 82, 83, 86, 88,  
90–92

**V**

Value chain management, 219  
Voluntary, 14, 100, 235

**W**

Worldcom, 42, 67, 78, 295, 296