



# Ethical management and leadership: a conceptual paper and Korean example

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## Abstract

Business ethics have become an important topic globally for both policy-makers and businesses. This paper first discusses the conceptual framework for business ethics followed by ethical management (EM) and corporate social responsibility (CSR) as well as relevant theories. Within this conceptual framework, Korea is used as a country context as to the development of EM and CSR. An important example of an ethical scandal is the major steel manufacturer, POSCO as it was held up as an exemplar and role model of ethical management. However, in 2015, it faced allegations that the engineering and construction overseas unit chief of its Vietnamese subsidiary created a slush fund by overstating payments to Vietnamese contractors. This conceptual paper discusses the factors that created this situation referring to the theory of connection. It locates the case in the EM and CSR literature and analyses what went wrong and what the parent company could have done to prevent this from happening.

**Keywords** Ethical management · Ethical leadership · Corporate social responsibility · Slush funds · Theory of connection · Korea · Vietnam

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## Introduction

With rapid expansion of global business, more nations and firms with different cultural and historical experiences are undertaking business transactions, with an increase in misunderstandings as to what are considered to be ‘proper’ business practices (Park et al. 2005; Ahmed et al. 2003, p. 89). National and international business transactions depend upon common perceptions of what is perceived as ‘acceptable’ behaviour (Ahmed et al. 2003, 89). In the case of Korea, with its rapid industrialization post-1960s, this created a high probability for misunderstandings based on different expectations between nations interacting in the global economy.

Business ethics can be defined as an individual’s or an organization’s morals, principles, and values (Ferrell et al. 2015) and can be seen as a particular sub-set of ethical management (EM), defined as a managerial function to regulate the conduct or behaviour of employees from top to bottom through written or unwritten codes that executives should implement when engaging in business activities (National Agricultural Cooperative Federation 2014). Such codes have become more important for many governments and businesses globally (Shin et al. 2015; Albrecht et al. 2010). The public nowadays is more concerned about ethical decision-making by individuals, groups, managers, and leaders within organizations. Yet, despite legislation around the world, e.g., the USA, Canada, and the EU, scandals still occur (McGregor 2017; Matthews and Gaudel 2015; Shen 2017). For example, the Enron case had major negative impacts because the company had stated that it had a highly moral and ethical culture but did not behave ethically (Ferrell et al. 2015).

Ferrell et al. (2015) point out that we live in a complex environment of ethical decision-making within organizations thereby making it difficult for individuals or groups to know whether their decision is the ‘right’ one. Decision-making for leaders (Trauffer et al. 2010; Vroom and Yetton 1973) is not a linear process but one in which both intra-personal and inter-personal aspects are part of the process and in which cognitive and social processes are inter-related in regulating the choices an individual makes. Furthermore, Albrecht et al. (2010) argue that cultural rationalizations affect the likelihood of fraud in cultures throughout the world. One can see this influence in the ethical decision-making process of individuals and is the case in parts of Asia such as Japan with some of its greatest names, including Olympus and more recently Toshiba, Nissan, Subaru, Toray, Misubishi, Kobe Steel Takata, etc. and in Korea with POSCO. However, some argue that many of the scandals within Korean society are not viewed as unethical but rather as smart financial movements (Ryu et al. 2015). Yet, a recent article (Ahn and Park 2016) studied how a company can achieve long-term survival and determined that it is not only economic performance but also social performance where CSR practices facilitate long-term survival. CSR actions have a positive influence on forming social capital with the primary stakeholders and secure legitimacy with the secondary stakeholders.

Korean companies have increasingly faced social and government pressure to develop and monitor their EM. Historically, due to Korea’s rapid economic growth post-1960s, corporations had a negative image (Kim 2015a, b, c; Lee 2002). From a cultural perspective, traditional values are predominant. Without changing attitudes toward business ethics and the concept of a fair profit whereby money is earned in an ethical manner, Korea went through this rapid economic growth, and even though

business leaders understood the need for EM, they did not put it into practice (Kim et al. 2015). Then, when circumstances did not allow the concept of fair profit to develop, Korea went through the International Monetary Fund (IMF) crisis in 1997. Thereafter, Korean society had a more negative view of businesses, such as poor management and corruption, partly because the middle class collapsed, creating a widening wealth gap. Today, EM in Korea is mostly influenced by corporate governance. This reveals that even though the *chaebols*—the large diversified conglomerates managed by the owner and family—only hold a small number of shares, they have a significant amount of influence on the entire organization because of cross-shareholdings. When the ownership of a Korean firm was broken down into different groups of shareholders (institutional, managerial, and foreign ownership), the results indicate a significant positive relationship between corporate social responsibility (CSR) ratings and ownership by institutions and investors, although shareholding by top managers is negatively associated with the firm's CSR rating (Oh et al. 2011).

Research into corruption, including bribery, embezzlement, kickbacks, and fraud, in the global construction industry found that to reduce the risk of corruption in developed and developing countries, companies can benefit from improved accountability, a focus on ethics and cultural issues, and reduced corruption (Sohali and Cavilli 2008). These initiatives can help construction projects be more sustainable and improve their construction practice in international projects. Research on corruption in the Korean construction sector argues that due to company size and huge capital outlay, corruption is far more profitable than in any other sector, thus outweighing the risk factor (Nolle 2010). Hence, our example of a recent global scandal, POSCO (E&C) Vietnamese subsidiary, is used.

The purpose of our article, through a conceptual framework for EM and CSR with theories related to EM, is to show the ethical decision-making process by management. It is organized as follows: First, it takes a conceptual approach by examining the various concepts that are part of the EM decision-making process leaders go through in detail. The use of secondary data in business ethics research (Cowton 1998) to build theories (Eisenhardt 1989) is acceptable in business ethics research. Then, it examines Korea as an example of EM and the historical development of its EM and CSR. Finally, it uses the case of an overseas subsidiary of a Korean *chaebol*, POSCO, that was involved in a corruption scandal at one of its overseas subsidiary. The secondary purpose of our article is to demonstrate, through this example that, despite decades of EM and ethical leadership implemented by its founder (Park and Kang 2014), scandals still occur. It poses the question of how, despite decades of being a role model for the EM, POSCO failed. In the spring of 2015, through media reports, the public were informed that POSCO Engineering and Construction (E&C) Vietnam had become embroiled in a scandal—allegations of bribery, kickbacks, and embezzlement (Choi 1999). Whether this scandal was only at the subsidiary level, or orchestrated from the head office, is an interesting question. At POSCO's 2017 CEOs Forum, it stated in its external environmental scan that the public had lost trust in it due to the building of a slush fund by its Vietnamese subsidiary and suspicion of acquiring an insolvent company. POSCO had previously had shown that its ethical leadership was highly revered, and furthermore, its award-winning code of ethics and its mandatory ethics training for its staff and management were superior to that of other *chaebols* and large organizations (Park and Kang 2014; Ehrlich and Kang 2004).

Our contribution to knowledge is to understand why organizations, such as *chaebols* and their leaders, may be susceptible to bribery and corruption and sets the stage for future research. The results are valuable because, using this case as an example, we argue that despite an organization being upheld as an excellent example of EM, ethical leadership and having implemented an award-winning code of conduct and ethics, these measures failed in the end to prevent another ethical scandal.

## Framing the concepts

This section discusses the concepts related to business ethics and EM and where CSR and ethical leadership are part of EM. These concepts are linked together in creating an ethical environment in which the players operate within an organization. Players then make ethical or unethical decisions in their decision-making process. Our focus, from a conceptual framework, is EM. Various theories will be discussed from within the realm of EM.

### Business ethics

The concept of business ethics (Ferrell et al. 2015, p. 5) is built upon definitions of morals, principles and values. With morals, the assumption is that businesses should hire people of sound moral principles. At the same time, though, businesses need to make a profit. However, if firms behave unethically, it will have a negative impact on their bottom lines. Businesses must create a balance between making a profit and satisfying the needs and desires of society. In dealing with the uniqueness of the business environment, society has implemented rules—both legal and implicit—for businesses to follow when earning a profit, so they will not harm individuals or society and will add to economic well-being.

Svensson and Wood (2008) introduced a business ethics model toward the creation of a conceptual framework for business ethics. It consists of three principal components (expectations, perceptions and evaluations) that are interconnected by five sub-components as to what society expects (organizational values, norms and beliefs; outcomes; society evaluates; and reconnections). In Svensson and Wood's (2011), conceptual framework of corporate and business ethics across organizations in terms of their ethical structures, ethical processes and ethical performance, it shows that changing societal and market patterns may force organizations to address ethical concerns across organizations. Chan et al.'s (2011) conceptual model examines the two dimensions of personal moral philosophy (Idealism and Relativism) and its influence on ethical decision-making. The model provides insight of the understanding of the philosophical and ethical analysis of managerial dilemmas. Davidrajuh's (2008) conceptual model for ethical business decision-making under the influence of personal relationships explores the ethical implications of personal relationships in business exchanges. This model is relevant in countries where personal relationships/connections are part of everyday business practices, such as in Asian countries, a major impact on the ethical decision-making process.

The conceptual framework linkages to ethical decision-making will now be discussed starting with business ethics then specifically EM with ethical leadership

and CSR as components of EM. The linkage is that they all have an impact on the ethical decision-making process especially EM. Within these concepts, several theories are introduced.

## EM

EM involves the set of related concepts of corruption, governance, and CSR. As EM involved ethical leadership and the corporate climate, they will be discussed under EM. Kaptein (1998, p. 42) defines EM as the systematic and coherent development of activities and the taking of measures to realize the fundamental and justified expectations of stakeholders and to balance conflicting expectations of stakeholders adequately.

Within EM is corruption, which does not have an agreed-upon global definition. Senior (2006) defines corruption as an action to (a) secretly provide (b) a good or service to a third party (c) so that a party can influence certain actions that (d) benefit the corrupt, a third party, or both (e) in which the corrupt agent has the authority. Kaufmann and Vicente (2005) include 'legal corruption', in which power is abused within the confines of the law. Corruption can act as a barrier for economic, social and political development and poverty reduction in less developed countries, such as Vietnam (Iqbal and Seo 2008; Bird and Smucker 2007; Aguilar et al. 2000). It has been argued that corruption has become less acceptable as a way of doing business internationally to various stakeholder groups (Ferrell et al. 2015; Hostleier 2011; Iqbal and Seo 2008; Sohali and Cavilli 2008; Aguilar et al. 2000). To create a less corrupt society (Sohali and Cavilli 2008), there must be more transparent governance. The United Nations (2007) defines transparent governance as the openness of the governance system that is achieved through clear processes and procedures enabling good access by citizens to public information. In Korea, the Anti-Corruption and Civil Rights Commission (ACRC), a quasi-government body dealing with corruption, has focused on improved governance, including a sound financial system. However, it has been argued that it is not a truly independent body because the President plays a key role in selecting ACRC commissioners (Kalinowski 2014). Scandals still occur despite laws implemented by the government.

Corporate governance, the related concept within EM, is defined as '... the system by which companies are directed and controlled' (Cadbury Committee 1992). The most important of the principles of good corporate governance is accountability to the enterprise's stakeholders, who rely on the controller's activities to protect and enhance the value of their equity. Due to many scandals involving corporate governance, the role of the board has been pushed forward into the public eye where the public/stakeholders are demanding a much higher degree of accountability (Adam et al. 2008; Beiner et al. 2006).

Finally, ethical leadership and corporate culture will be discussed as being part of the conceptual framework of EM. Models of organizational leaders' influences on culture and ethical climates are common (Schein 1995; Lewin and Stephens 1994; Schein 1985). Culture has been identified as a significant determinant of managers' ethical attitudes (Hitt et al. 2007; Cho and Yoon, 2001; Christie et al. 2003; Ireland and Hitt 1999; Song and Meek 1998; Cho 1995). Some (Kim and Kim 2009; Park et al. 2005; Christie et al. 2003; Fritzsche et al. 1995), using

Hofstede's (1991) cultural typology, have shown that national culture has a strong influence on managers' ethical attitudes.

Research (Lee and Yoshihara 1997) has found that the ethical view of Korean (and Japanese) business managers consists of five theories: deontology, utilitarianism, relativism, managerial egoism, and justice. When executives believe in the social responsibility of business and social justice, they have deontological attitudes, especially about issues that have important ethical implications. For minor problems, such as gift giving, refraining from disclosure of full information unless asked, or bribery in foreign countries, managers take the utilitarian approach, which creates the issue of 'questionable payments' (Bird and Smucker 2007; Sohali and Cavilli 2008; Smucker 2005).

Ongoing examples of Korean companies acting unethically (Rowley and Oh 2017) have raised the question of ethical leadership and why, despite legislation and companies having introduced EM since the early 1990s, executives or founders continue to act as such poor role models instead of the key sources of ethical guidance to their employees (Shin et al. 2015; Brown et al. 2005). Research has shown that company founders have a major impact on the initial culture within an organization and the establishment of an ethical climate (Ki et al. 2012; Kang et al. 2011; Nelson 2003; Robbins and Judge 2014), where the person-leader fit (P-L fit) affects an employee's ethical decision-making with outcomes interacting with ethical leadership. Research into ethics-based leadership across cultures (Resick et al. 2006, 2011) found those societal beliefs about leadership (House et al. 2004), and being able to understand these differences (Dickson et al. 2003; Jackson 2001) can influence leaders in engaging in ethical behaviour.

Victor and Cullen (1988) identified nine types of ethical climate based on philosophical approaches. The locus of analysis for the ethical criteria, based on egoism, benevolence and principle, is individual, local and cosmopolitan. At the individual level, they are self-interest, friendship and personal morality. At the local level, they are company profit, team interest, and company rules and procedures. At the cosmopolitan level, they are efficiency, social responsibility, and law and professional codes. Often organizations have a dominant ethical climate, but several types of ethical climates can coexist in the same organization (Victor and Cullen 1988). An ethical program can strengthen an organization's ethical climate, leading to a decrease in unethical behaviour within the organization (Park and Blenkinsopp 2013), and there is a positive association between the ethical leadership of the founder of a Korean company, POSCO, and its ethical climate (Park and Kang 2014). Recent evidence (Shin et al. 2015; Ki et al. 2012) shows that top management ethical leadership significantly predicts ethical climate, which then results in a procedural justice climate which fully mediates the effects of top management ethical leadership on two organizational outcomes: firm-level organizational citizenship behaviour and firm financial performance.

Research into institutional indicators, such as competitive versus non-competitive contracts (Schopf 2011), shows a positive trend toward a more competitive framework. However, competition itself will not reduce corruption if the framework is weak. Patterson and Walcutt (2014) looked at the regulatory and cognitive-cultural dimensions of why Korean firms did not follow government gender policies and concluded that it was due to a lack of policy enforcement.

## Corporate social responsibility

Definitions of CSR have proliferated since the 1950s, and it remains a contested concept (Okoye 2009). In contrast to traditional views that an organization's primary (if not sole) responsibility is earning a return for investors and complying with laws, others argue that there are 'higher' responsibilities that are ethical and philanthropic (although profitability remains primary). This extension of an organization's economic responsibilities to non-economic (or social) domains was popularized by Carroll (1979) whose conceptualization has been durable and widely cited. His CSR 'pyramid' of four layers of organizational responsibilities suggests a sequential order, weighting and evolution of importance and development. Thus, the early emphasis on the economic (profitability) is followed by the legal (law-abiding), then ethical (conducting affairs in a fair and just way to more than just comply, but to also make proactive efforts to anticipate and meet society norms), and finally discretionary (to be socially supportive and good citizens through, for example, philanthropic support for communities, donating employee expertise and time to causes, etc.) responsibilities in business conduct (Carroll and Hoy 1984).

Other constituencies, such as employees, suppliers, customers, local communities, governments and other special interest groups or stakeholders, have also been incorporated into CSR (Carroll and Hoy 1984). This moved CSR closer to stakeholder theory that organizations must be responsive to the competing demands of multiple stakeholders (Freeman 1984). The ease with which Carroll's (1979) taxonomy can be operationalized has aided its longevity, and it remains popular (e.g. Lee et al. 2012a, b; Zhang and Gowan 2012). Carroll's three-dimensional conceptual model of corporate performance addressed some key questions of academics and managers, specifically the following: (1) What is included in CSR? (2) What are the social issues the organization must address? And, (3) what is the organization's philosophy or mode of social responsiveness? Wang's (2011) research found that the CSR objective of a corporation's top management should be to manage the divergent and conflicting interests of multiple stakeholders, taking into consideration key stakeholders but others as well and that the importance of values as a driver of ethical behaviour and decision-making must be recognized. Kim et al. (2013) found that Korea shows more concern for short-termism than for sustainability and for a normative more than a strategic orientation in its CSR. Many Korean institutional factors, acting in intricate ways, create complex and dynamic pressures for CSR practice, and corporations make the decision to follow government policy or not (Patterson and Walcutt 2014). Lee and Kim (2014) explored the development and practice of CSR in the different theoretical CSR perspectives and found that these institutions (high regulative pressure, unique normative setting and critical cognitive-cultural environment) affected Korean companies in the adoption, implementation and practice of CSR due to government regulations, legislation and policy. An analysis of the effect of ethical behaviour on a firms' financial profitability (Vieira 2013) where CSR was used as an indicator of ethical performance found that ROA is significantly related to a firm's ethical performance; therefore, EM is of high importance.

## Ethical management versus corporate social responsibility

EM and CSR are similar in that they both focus on the social responsibility of individuals at the management level, but they differ slightly as to the role within an organization. EM is a set of concepts of which CSR is a part of. CSR means that an organization has an obligation to maximize its positive impact on stakeholders and minimize its negative impact (Ferrell et al. 2015). A model of corporate moral development created by Reidenback and Robin (1991) has since been modified by others as models for CSR and EM (Carroll 1999). Here, the ethical decision-making process involves not only the individual's stage of moral development but also other factors such as corporate culture, with corporations being classified according to their stage of moral development. The conceptual model is a pyramid with at the top the highest or most advanced stage of moral development (the 'ethical' corporation) and at the bottom the lowest or least advanced stage (the 'amoral' corporation).

The next section will give an overview of the historical content of Korean EM. The effect of Confucianism on ethical beliefs is discussed and then followed by the developmental approach of EM in Korea.

## Overview of Korean EM

Our research offers an unusual context for both EM and CSR as both Confucianism and collectivism are evident (Park et al. 2005; Choi 1999). Recent empirical evidence (Chang et al. 2015) on the relationship between a board's characteristics and CSR shows that Western-based literature has a linear relationship, whereas in Korea, various relationships between board characteristics and CSR were non-linear. The authors concluded that there is no universal feature of CSR-supportive board characteristics due to the unique characteristics of various institutional contexts. Also, CSR development was not totally voluntary but imposed via codes of conduct, although the government may not continue to be the dominant force in CSR as the influence of other stakeholders—consumers, employees and civil society—expands. This may be particularly true after several high-profile events and corporate scandals. Also, sustainable behaviours, such as purchasing organic food, responsible use of transportation and giving to charity, have been found to be significantly more common in Korea than in the US and Germany (Ngyuen and Rowley 2015).

The following section begins with the influence of Confucianism on ethical beliefs in Korea and outlines the historical context of EE as well as CSR in Korea. According to the International Institute for Management Development (IMD) survey (2000–10), Korean companies ranked 34th among the 55 countries surveyed, inferring that they only focused on legislation for their code of conduct and related acts with a lack of emphasis on specific practices and programs to be implemented after their code of conduct (Kwon 2011). During the 2000s, many *chaebols*, such as Samsung, LG, Hyundai, SK, and POSCO adopted EM policies by which codes of conduct or ethics were implemented, but small and medium-sized enterprises (SMEs) were unaware of EM. The government agreed with the OECD that EM must be a requirement for companies. However, after 2001, several corporate scandals emerged (Kwon 2011; Choi and Jung 2007). For example, Samsung used slush funds to bribe prosecutors,



judges and politicians, and several *chaebol* CEOs were found guilty of fraud, embezzlement, bribery and corruption. This shows that the introduction of EM by companies was not effective in reducing unethical business activities (Albrecht et al. 2010).

### Confucianism and ethical beliefs

Misunderstandings can occur due to cultural differences about business practices (Park et al. 2005; Ahmed et al. 2003; Fritzsche et al. 1995). For example, the business ethics culture of the US has been affected by its European heritage and Judeo-Christian philosophy (Ferrell et al. 2015), whereas East Asian countries are influenced by Confucian philosophy (Kwon 2011; Kim and Kim 2009; Cho and Yoon 2001; Choi 1999; Li 1999). Two cultural dimensions that could affect business ethics in Korea are Confucianism and collectivism because they are viewed as the typical cultural and psychological traits (Park et al. 2005; Ma and Smith 1992; Hofstede 1991). Confucian ethical philosophy emphasizes strict hierarchal order for human relationships based on age and gender (Janelli et al. 1993; Chang and Chang 1994).

Korea evolved from a nation with strong historical religious/ethical traditions that had a significant effect on its business practices and still have an effect despite its rapid integration into the global economy (Kwon 2011; Cho 2009; Ahmed et al. 2003; Choi 1999). It might be argued that Korean society is now less concerned about preserving traditional Confucian values (Kwon 2011), but certain aspects remain important, specifically the ethical rules governing human relationships, family-centred individualism and education as a means of worldly success (Rowley 2013; Kwon 2011). One of the significant ethical attributes is dedication to family. In Korean society, this influences the relationship between supervisors and their subordinates in organizations (Park et al. 2005; Cho and Yoon 2001; Janelli et al. 1993; Ma and Smith 1992; Yum 1991), with the family-dominated system extending its strong patriarchal authority to organizational behaviour (Rowley 2013; Rowley and Paik 2009; Kim and Park 2003; Cho and Yoon 2001; Choi 1999; Janelli et al. 1993). Domestic paternalism was adapted to modern industrial conditions during Korea's post-1960s rapid industrialization period, with the individual being expected to give supreme allegiance to the company's interests and identify completely with the company's goals (Kim and Park 2003; Janelli et al. 1993; Yoo and Lee 1987).

Individual differences in perceptions about the individualism-collectivism dimension (Hofstede 1991; Kibum and Uichol 1997; Park et al. 2005) indicate that moral behaviour among cultures may differ despite sharing the same moral values (Fritzsche et al. 1995). Variations in ethical practices across cultures (Fritzsche et al. 1995; Dubinsky et al. 1991) occur for two reasons. First, some individuals may be adhering to extant hyper-norms, while others are not. Second, the cultures may be operating under different sets of community norms. Culturally based ethical conflicts can be classified into three categories (Hendry 1999, p. 406–407). First, the ethical values characteristic of the two cultures lead to opposite conclusions. Second, one culture attributes moral significance to something that another does not, such as practices that are morally unacceptable in one culture being acceptable in another because they are not seen as having any significant moral impact. For example, gift giving in Korea has been traditionally used for the development and maintenance of social relationships, but it creates an international ethical issue because some view it as bribery and corruption.

The international perspective of Korea, with its low ranking regarding bribery and corruption by Transparency International (1), is based upon its long history of corruption and bribery (Kalinowski 2014). Third, contingent situations give different interpretations of what is ethically acceptable.

In the following section, we analyse approaches to EM in four historical post-1997 phases that we developed.

## **Developmental approaches for EM**

### **Phase I: introducing EM from Western examples (1997–2002)**

In this early stage, companies faced the Asian financial crisis with many in survival mode. EM was not a priority as they were adopting several Westernized management strategies, such as restructuring, downsizing, layoffs and early retirements. EM was seen not being an urgent or critical business process, despite awareness of it as a growing global trend (Kim 2015a, b, c; Lee 2002). In 1993, POSCO first introduced EM with such measures as a code of conduct/ethics followed by similar developments in LG in 1994 and Samsung in 1995.

### **Phase II: government intervention: emphasis on transparency (2003–2007)**

Former President Noh Moo-hyun's administration had a form of 'participatory government' in which non-governmental actors, both individuals and organizations, were to be involved in developing policy (Tamyalew 2013; Edwards 2008). Thus, the focus on EM for Korean companies was to change their culture of corruption. Due to pressure from the government, *chaebols* benchmarked their EM systems (Ethisphere Institute 2015) with those in the West, such as 3 M, Ford and L'Oreal. Korean companies implemented their codes of conduct in theory, but in practice, the majority were not following those codes (Kim 2015a, b, c), despite the government wanting them to internalize their codes, like US companies, with an internal monitoring management system. For Korean companies to learn how to follow their codes of ethics, positions were created for officers to police this area (Kim 2015a, b, c; Kim and Kim 2009).

Companies were in the initial stage of EM and the government began to improve its legal and institutional frameworks by increasing transparency in corporate management and promoting ethical business practices. However, corruption could not be eradicated without eliminating public sector corruption because the two areas are invariably interlinked. The government focused on a public-private partnership to confront corruption, especially through the implementation of the Korean Pact on Anti-Corruption and Transparency (K-PACT). The business sector increased its efforts to improve business ethics due to pressure from the anti-corruption movement driven by Korean society (Kim 2015a, b, c; Iqbal and Seo 2008; Choi and Jung 2007; Lee 2002). In 2005, a survey found that the major external problem was corruption by those in public organizations and the biggest internal problem was inadequate managerial skills (SERI 2005). In 2006, the FKI released that a report on EM showing over four-fifths of firms had introduced an ethics chapter as part of their corporate policy (84.1%) and had implemented (86.6%) EM (Kang 2006). Despite government guidelines for EM being adopted since early 2000, Korean companies did not improve their scores for

corruption as examples of unethical behaviours continued (SERI 2006). In 2006, Hyundai Motors' CEO was convicted for embezzlement and over KRW 100 million slush fund despite a KRW 400 million loss. In 2007, Samsung bribed prosecutors and government officials according to a whistle-blower who was a former chief secretary of its legal department.

### **Phase III: government intervention: emphasis on self-regulation (2008–12)**

In 2008, under former President Lee Myung-baek's administration, there was a shift from transparency to self-regulation for companies (Tamyalew 2013). Simultaneously, Presidential pardons were given to CEOs of companies such as Samsung and Hyundai who had been sentenced for unethical business practices (SERI 2012). This had a negative impact on EM in practice, creating a more unethical business environment. Despite this, EM did improve in terms of paperwork and systems. These trends persisted through 2012 and unethical business practices were revealed. For example, in 2012, the CEO of Hanwha Group was arrested for breach of trust and embezzlement and the CEO at SK group was sentenced for embezzlement. During this period, 'personnel parachutes', whereby large firms hired former public officials and politicians, were a very popular practice. For example, according to the Korean Ministry of Strategy and Finance ([www.alio.go.kr](http://www.alio.go.kr)), more than 70% of those in executive level positions had been former high-ranking government officials or politicians. In addition, based on an analysis of 287 companies in the public sector, 295 executives were former government officials, with 44 people from the Blue House (the President's residence) and 251 from the government. This created a serious challenge to improving EM.

### **Phase IV: government intervention: emphasis on economic democratization (Post-2012)**

After former President Park Geun-hye was elected in 2012, the administration raised the issue of 'Economic Democracy', especially regarding the *chaebols*. Korean companies are sensitive to government policy; if they fail to follow the guidelines for EM, they will no longer be able to stay in business. Park's administration sent a strong signal to companies that they should follow EM for the public good (Tamyalew 2013; 'Statement on Park Geun-hye as Korea's Newly Elected President' 2012, December 2012). Despite this, in 2013, Samsung Electronics tried to disguise its toxic gas leak at a semi-conductor manufacturing facility in HwaSeoung, Korea, and the Shinsaegae Group blocked the formation of a union by its employees. Due to these cases, the government and society blamed the *chaebols* for failing to follow EM guidelines (Tejada 2017, February 17; Kalinowski 2014).

Recent trends indicate that Korean companies are slowly moving to the next step in EM, from policy building to actual practice (ACRC 2014; Kalinowski 2014). The government has been asserting pressure to require *chaebols* to implement stricter EM rules (iHS Korea April 9 2015; Kalinowski 2014; Tamyalew 2013; Transparency International Korea December 20 2012). The *chaebols* are expanding EM to create a good public image and improve their transparency, such as compliance. For example, Samsung Group emphasizes its social contribution to the public when it organizes its supporting team under the direct control of its CEO, evaluates the level of compliance

scores for its executives and utilizes performance evaluations for promotion and staffing purposes. Similarly, SK, Shinsae-gae and Lotte Group have expanded their special areas for social contributions or CSR. Companies such as DaeWoo E&C and KDC Co., Ltd., have introduced EM and transparency. For example, their websites state that ethical and transparent management is internalized within their corporate culture, and they have implemented a firm-wide foundation of awareness, enabling individuals to voluntarily incorporate ethics management into their work based on their own high standards of ethics, a more proactive approach to their EM policies and practices; this will inevitably become a management strategy toward their companies' sustainable growth. Of course, such proclamations can clearly be simple management PR, assertion and rhetoric, not reality.

Korea is now reforming corruption with ACRC (2014). A report by the World Bank (Kalinowski 2014) on the effectiveness of this commission pointed out that since 2002, the implementation of anti-corruption reforms has earned high-level political support. However, there were problems, for example, ACRC focused on middle and lower-level officials and did not cover all levels within the public sector, nor did it target high-ranking officials and the private sector. Furthermore, it needed to increase its efforts to fight and prevent corruption because most of corruption is between business and government. When a country is implementing policies to eradicate corruption (Scott 2004; Nielsen 2000), the politics of reform need to be embedded within due a predatory networking-based, corruption sub-system. In Korea, the politics of its corruption sub-systems are embedded within its social structures, sustained by the collective action of interest groups that benefit from the corruption (Tamyalew 2013). There are subtle types of corruption networks, such as 'crony capitalism' (Kalinowski 2014), informal networks of *chaebols* and government control over activities (Kwon 2011), such as loans from state banks. Despite improvements in transparency, democratic accountability and prevention of corruption, many issues persist because democratic behaviour is not truly part of Korean society and competing networks have prevented a universalistic attitude toward the common good (Kalinowski 2014; Tamyalew 2013).

Based on the above, an example of a Korean company, POSCO, will now be discussed to demonstrate how a predatory networking-based corruption sub-system severely weakens an EM framework. Thus, it creates opportunities for unethical decision-making by the players involved.

## An example of a lack of EM

We use the POSCO E&C Vietnam slush fund scandal as an example of a lack of EM. The case will be outlined below. In the spring of 2015, POSCO became embroiled in allegations of slush funds worth KRW10 billion (approximately US\$9 million) created by the former overseas unit chief of its Vietnamese subsidiary (Park 2015; Kim 2015a, b, c March 20; Cho 2015 February 27; Son-Van Khoa 2015) by over-inflating the costs of building ODA-funded expressways in Vietnam from 2009 to 2012 in collusion with local contractors (Jung 2015; Thanh-nien News 2015 April 26). In this section, it will show how the release of information was not initiated by POSCO but through various Korean and Vietnamese media sources over several months. The Vietnamese government and the public became aware of the unethical business ethics decision-making

process and corruption within this subsidiary from 2009 to 2012 through these media sources and not through POSCO headquarters. Various key figures within POSCO were investigated by the Seoul District Prosecutor's Office and, in the end, were indicted by the Korean government as well as key political figures.

First, an inquiry by the Korean National Assembly in February 2015 revealed that POSCO E&C executive members at their overseas Vietnamese construction site had been internally punished in July 2014 for creating a slush fund of over KRW10 billion (US\$9 million) (Cho 2015 February 27). Former Prime Minister Lee Wan-koo ordered the judicial authorities to investigate the case at this point. According to POSCO E&C, some of its executive members in charge of projects in Vietnam created the slush fund by exaggerating payments to its Vietnamese subcontractors between 2009 and 2012 whereby the fund was paid to ordering bodies each month. We note that an industry expert stated that: 'Such rebates paid at the request of ordering bodies are a kind of business practice in many overseas construction projects. However, this case is somewhat unusual in that a huge amount was paid over a long period of time, and the company was not aware of the payments'—an attempt to say these payments were not bribes.

Then, in March 2015 (Jung 2015 March 25; Jung 2015 March 17), the prosecution announced that former POSCO E&C Vice Chairman Chung Dong-hwa was the alleged key figure in the slush fund scandal as it was created during his reign. The creator was former executive, Park, who oversaw POSCO E&C Vietnam between 2009 and 2011 of the KRW10 billion slush fund. Prosecutors suspected Chung of ordering Park to set up this fund or was involved in it as over KRW4 billion was transferred to Korea, where it was alleged that POSCO used it as kickbacks to high-profile policy makers under the former Lee Myung-baek's administration (Ryu et al. 2015). Prosecutors detained Park and raided the offices of three companies acting as subcontractors for POSCO E&C's projects in Vietnam. The overseas unit chief and POSCO E&C argued that the funds were used as a rebate paid to the builder's subcontractors. However, the Korean prosecution, through its investigation, found sufficient evidence that a significant amount of money had been diverted elsewhere (Korea Herald March 20, 2015b). This then led to the suspicion that the POSCO unit had taken the funds to give bribes to influential Vietnamese politicians. On March 17, 2015, Dong-A Ibo reported that prosecutors were investigating the alleged corruption scandal and summoned the company's two executives and others who reportedly organized the slush fund in Vietnam. In addition, the Seoul Central District Court found irregularities in the company's domestic business operations and were examining when to summon former POSCO Chairman Chung Joon-yang and former POSCO E&C Vice Chairman Jeong Dong-hwa. At this point in time, the prosecutors were focusing on proving that the former president of POSCO E&C's Vietnam office and others had created this slush fund, while conducting capital deals with its supplier for the Vietnam construction project and offering a rebate to the construction organization with some executives embezzling some of the funds in the process. Additionally, they wished to prove that former Vice Chairman Jeong engaged in various corruptions in domestic operations while in office and whether the secret funds were sent to high-level officials in the Lee Myung-baek administration. In 2009, when Chung Joon-yang became chairman of POSCO Group, there were allegations that the former National Assembly deputy speaker Lee Sang-deuk and the former Knowledge and Economy Vice Minister Park

Young-joon had intervened in the chairman's nomination and in POSCO's various M&A projects. The incumbent POSCO Chairman Kwon Oh-joon issued a statement to the public and shareholders that a priority would be placed on business ethics.

The Vietnamese newspapers published a series of articles beginning in April 2015. On April 4, 2015, *Voice of Vietnam* and the *Thain News* reported that the Vietnamese Ministry of Transport was reviewing contracts signed with POSCO Engineering and Construction due to POSCO being under investigation in Korea for operating this slush fund in Vietnam. It was pointed out that the ministry learned about the POSCO scandal through media reports, indicating a lack of transparency by POSCO and the Korean government authorities. During the period in question, the company oversaw three sections in the construction of the Noi Bai-Lao Cai Highway, funded by the Asian Development Bank and completed at the end of 2014. POSCO also had a contract for two sections of the Long Thanh-Dau Giay Highway project. The Vietnam Expressway Corporation invested in both projects which ran behind schedule and had some quality problems. Deputy Minister Truong stated that all the projects had been checked by their foreign sponsors and state auditors' initial inspections found no issues in that all procedures related to management and investment complied with the law. He added that POSCO E&C had won the bids with prices 15–30% lower than investors' estimates. When asked about the company's claim that it had given bribe money to paying its subcontractors, Truong stated that it was POSCO's business and that the ministry and the Vietnam Expressway Corporation would not interfere. Then, on April 6, 2015 (Ha 2015 April 6), it was reported that POSCO, together with Keangnam and Doosan, had been named by the Vietnamese Ministry of Transport as the worst international contractors. The report stated that POSCO, even though it had the winning bids to execute large-scale projects, could not demonstrate that it had more outstanding capability than that of the domestic contractors and that POSCO had issues with some of the construction works, whereby in December 2013, Cho Yang-ook of POSCO E&C and several Vietnamese were disciplined by the ministry. Furthermore, Minister of Transport Dinh La Thang noted that the Korean contractors bid low prices to obtain the contracts and Mai Anh Tuan, VEC's General Director, the investor of the projects, noted that with such low bids, the contractors had to have hired unqualified subcontractors. Next, on April 9, 2015 (*Thanh News*), the Vietnamese Ministry of Transport announced that it would conduct an inspection into five sections of two expressway projects contracted to POSCO E&C specifically into the process of selecting contractors, assessing and making payments to find any possible wrongdoings and violations of the law. That week, Kwon Sang-kee, an executive in charge of Southeast Asia of POSCO E&C, sent a letter of apology to the Ministry of Transport and Vietnam Expressway Corporation (VEC) for their inconvenience.

After all the various negative media reports, on May 7, 2015 (Lee, May 7, 2015), POSCO announced that it was taking measures to restructure its business practices and to deal with issues domestically and abroad. Chairman Kwon Oh-joon outlined five strategies for the steelmaker to become a more profitable and socially responsible corporate citizen. The fourth and fifth strategies were to conduct business with partners transparently and enhance EM. Kwon stated at a press conference that POSCO would establish a committee to oversee its decision-making to clarify who is responsible for decisions, implement a personnel reshuffle to hold executives responsible for failed projects and poor management, and introduce a performance-based personnel

management system to appoint talented workers to the right positions, while making the way employees do business with partners more transparent to prevent them from being engaged in illicit dealings. The company stated, ‘... it will place top priority on strengthening ethical management’. Kwon stated: ‘POSCO will dismiss employees, regardless of their rank, who took bribes or engaged in other dubious activities, and refer them to the prosecution’. Then, on May 13, 2015 (Kim 2015a, b, c April 6), POSCO announced that it had formed an internal committee to restore its global image negatively impacted by this slush fund scandal. The committee, headed by POSCO Chairman Kwon Oh-jun, was comprised of the company’s executive board members as well as the heads of five major affiliate firms, including Daewoo International Corp., POSCO E&C and POSCO Energy Co. The focus of the probe now included POSCO’s former chairman Chung Joon-yang, and his management team as a series of M&A deals signed under his leadership between 2009 and 2014 was regarded to have been politically motivated. During Chung’s 5-year term, POSCO’s debt dramatically increased from KRW9 trillion to KRW14 trillion (US\$800 M to 14 M), resulting in assets being sold and other restructuring initiatives to improve its financial health and overall image of itself and its affiliates. POSCO stated that purpose of the committee was to create concrete reform measures, including strengthening its business ethics.

On September 11, 2015 (Noh 2015 September 11), former POSCO CEO Chung Joon-yang appeared for questioning at Seoul Central District Prosecutors’ Office. Prosecution found that Chung allegedly gave KRW185 million (approximately US\$200 million) to his brother-in-law in return for placing an order for road construction in Vietnam for the company. The investigation into allegations of corruption at POSCO, which had focused on internal corruption at the company for more than 6 months, turned into an investigation of illegal political funds aimed at high-level politicians in the administration of former President Lee Myung-baek (2008–2013). This was because illegal political funds were being laundered through work to sub-contractors. Several members of the so-called ‘Yeongpo Clique’, influential figures with connections within POSCO’s headquarters in Pohang, Korea, were the target of the prosecutors’ investigation which also found another interesting connection—the 7000 Club—a group of seven politically influential people from Pohang. Allegedly, the seven members raised money from POSCO subcontractors, giving a substantial amount of this money as bribes to powerful figures in the Lee Myung-baek administration—indicating unethical relationships between POSCO and regional politicians. In the final conclusion to the investigation in November 2015 (Chung 2015), prosecutors indicted Chung Joon-Yang, the former chairman of POSCO Group, along with 31 others involved in the alleged scandal.

### **Discussion and recommendations: how to improve business ethics and EM in global operations**

Whenever a new administration was inaugurated, POSCO faced similar accusations of political influence in its business practices (Kwon 2015, April 9). POSCO, in the past, was always investigated for scandals whenever a new government was voted in (Dong-A Ibo 2015 March 17). In 1993, the late former Honorary Chairman Park Tae-joon was indicted for allegedly receiving bribes. In 1994, under the Kim Young-sam administration, former chairman Kim Man-je took office in 1994 but resigned immediately

when the Kim Dae-jung administration took office and former Chairman Yoo Sang-boo was also indicted for breach of duty. In 2009, former Chairman Lee Ku-taek resigned 1 year before his official term ended when the Lee Myung-baek administration came into power. POSCO was privatized in 2000, but due to the absence of a clearly defined 'owner', constant disputes occur from political pressure as to executive nominations and resignations.

This case is unusual because a substantial amount of money was paid out from 2009 to 2012, with the company stating it was unaware of the payments (Cho 2015, February 27). The question is why this happened despite the EM of the parent company, POSCO, having implemented, with the example set by its founder, as to ethical leadership (Park et al. 2014). POSCO's reputation for setting the standard for EM for the past 20 years in Korea is now at risk.

How did this happen to Korea's role model for EM? As discussed above, the Seoul Central District Prosecutors' Office conducted an 8-month investigation into the allegations of suspicious deals and the alleged slush fund and indicted the former POSCO chairman and 31 others. Therefore, one could infer that these key players viewed certain contingent situations as allowing them the freedom for different interpretations of what is ethically acceptable for their subcontractors operating overseas to become involved in.

With the issue of bribery in foreign countries, especially with construction projects, it can be argued that managers take a utilitarian approach, which creates the issue of 'questionable payments' (Bird and Smucker 2007; Sohali and Cavilli 2008; Smucker 2005). With the POSCO E&C Vietnamese subsidiary, the Seoul Central District Office alleged that the former chairman, Chung Dong-Hwa, had a subcontractor give KRW185 million to his brother-in-law in return for placing an order and the slush fund was created while conducting capital deals with its supplier for the Vietnamese construction project. A rebate was offered to the construction-ordering organization and its subcontractors and a significant amount of that money was transferred elsewhere (Dong-a Ilbo 2015 March 17; Kim 2015a, b, c, March 20). Therefore, one can infer that the rebate is a form of a questionable payment.

As pointed out earlier, research (Resick et al. 2006, 2011) into ethics-based leadership across cultures found that societal beliefs about leadership (House et al. 2004) and being able to understand these differences (Dickson et al. 2003; Jackson 2001) can influence leaders to engage in ethical behaviour. Through the example of POSCO E&C, despite legislation, EM and pressure from the government to put organizations' policies into practice (ACRC 2014; Kalinowski 2014), its leaders have not engaged in ethical behaviour, as the investigation of their unethical practices indicates. Former POSCO E&C Vice Chairman Chung Dong-hwa allegedly helped the friend of a high-ranking government official secure a position in his company in 2011. He was awarded the highest honour for industry development from the former government in 2012 (Chung 2015, November 11). He is suspected of embezzling funds from 2009 to 2013. Fifteen other former and sitting POSCO executives, heads of 13 subcontractors and a vice president of Korea Development Bank were indicted on charges of bribery and breach of trust. Thus, despite legislation and EM by Korean organizations, unethical behaviour continues. As stated earlier, research shows a positive correlation between the relationship between the ethical leadership of the founder of a Korean company, POSCO, and its ethical climate (Park et al. 2014). However, despite these researchers, it



appears that ethical leadership of the founder did not have a positive influence on the EM by top level executives of POSCO and its subcontractors, which created an unethical climate, not only at its overseas operations, but also domestically.

As discussed above, whenever a new government's administration is appointed, POSCO has always been its target since it was privatized in 2000 because of allegations of bribery and corruption (Dong-A Ilbo 2015, March 17). The former government of President Park Geun-hye, under political pressure about executive nomination and resignation, continued investigations due to the absence of a clearly defined 'owner'. As stated, the *chaebols* are under pressure to implement stricter EM rules (iHS 2015, April 9; Kalinowski 2014; Tamyalew 2013; Transparency International Korea 2012, December 20), but it has not proven effective to date. Most interesting is that the former President Park Geun-hye was jailed in March 2017 charged with corruption showing that the current government is enforcing the law, a positive change as Transparency International in 2014 indicated that Korea only had moderate enforcement. However, evidence shows that despite improvements in transparency, democratic accountability and prevention of corruption, many Korean organizations fail to meet the standard. Former POSCO Chairman Chung Joon-yang (2009–2014) helped secure domestic and overseas projects using his network to obtain these contracts; he used bribes to secure contracts or influence peddling to get approval for domestic because there is stiff competition among the *chaebols*, thus preventing a universalistic attitude toward the common good (Kalinowski 2014; Tamyalew 2013). This leads to the next section covering ethical decision-making theory and applicable conceptual model.

### Ethical decision-making theories and a conceptual model

Davidrajuh's (2008) conceptual model for ethical business decision-making under the influence of personal relationships is an appropriate model for the case of Korea and other countries where personal relationships/networks form part of the ethical decision-making process. This refers to the Theory of Connection (Davidrajuh 2008, pp. 1–2) for the model development to form a systems perspective of the ethical decision-making process, what are the elements and environments involved in the decision-making process, how the elements are connected or related to each other, etc.

The ethical theories related to business exchanges are Stockholder Theory, Stakeholder Theory and Social Contract Theory (Davidrajuh 2008, pp. 4–5), as they are normative theories. With Stockholder Theory, the only social responsibility of business and its agents is to engage in business activities to increase profits; therefore, there is open and free competition with deception or fraud (Davidrajuh 2008; Pearlson and Saunders 2006). For Stakeholder Theory, there is an obligation to the stockholder and the agents are responsible ensuring that the interests of all stakeholder groups of the business, thus, creating a balance for all the rights of the stakeholders (Davidrajuh 2008; Freeman 1984). In Social Contract Theory, the agents are responsible for bringing benefits to the member of a society, giving legal recognition ('social contract') to a corporation to employ social resources toward given ends (Davidrajuh 2008; Smith and Hasnas 1999). Davidrajuh (2008) argues that these normative ethical theories do not give mathematical models for measuring the economic benefits to the various parties involved as they are qualitative in nature (Davidrajuh 2008, pp. 7) and developed a new conceptual model for the ethical decision-making process using the Theory

of Connection (Bjorke, 1995). This consists of three fundamental components: elements, connections and sources. Bjorke (1995) argues that some of the elements in the ethical decision-making process are human resources (interacting agents, business managers, shareholders, etc.), computer and network resources and buildings and offices of the businesses and that the sources are environment's influence on the connected system. Davidrajuh (2008) argues that it is the agent's moral judgment that forms any business decision and it is depends upon their ability to recognize moral issues, to establish moral intent, engage in moral behaviour, and recognize the characteristics of the moral issue, and the moral judgment will be impacted by his or her own characteristics or personality (Haines and Leonard 2007).

### Principles or recommendations for less corrupt business practices

As mentioned earlier, Nolle's research (2010) on corruption in the Korean construction sector argues that due to company size and huge capital outlay, corruption is far more profitable here than in other sectors, thus outweighing the risk factor. Hence, one can infer that therefore POSCO's senior executives, who allowed bribery to occur, felt the potential of high profits for the Vietnamese construction project outweighed the risks. To create less corrupt business practices, according to Bird and Smucker (2007), there are three principles or recommendations international firms must consider when assessing their CSR in developing countries. First, applicable to the case of POSCO E&C, is an awareness of the historical and institutional dynamics of the local area about its construction projects. Despite having an international code of conduct, it must also have these dynamics in place to improve the social and economic assets of the local areas in which it is operating. Second, there must be open, non-intimidating communication with constituents, including representatives from the host community. Third, the organization's operations must be safeguarded as to sustainability and if not, for the improvement of economic and social assets of the host community.

### Conclusion

Our paper has discussed several different concepts and theories. Davidrajuh's (2008) conceptual model for ethical business decision-making under the influence of personal relationships is an appropriate model for the case of Korea and other countries where personal relationships/networks form part of the ethical decision-making process. The conceptual model for the ethical decision-making process uses the Theory of Connection (Bjorke 1995) as it consists of three fundamental components: elements, connections and sources.

Korea is used as a context for this conceptual model with POSCO as the case for an unethical decision-making process. The previous Korean government had declared that it would prosecute any organizations that engage in unethical behaviour; however, Korean society does not trust such declarations by its government. Transparency International's (2014) measurements of corruption perception at 55/100 (2014) bribe payers (2011) at 7.9/10, enforcement (2014) as moderate, and control of corruption (2010) at 69/100 showing that despite previous presidential administrations stating such declarations, it does not prevent ongoing unethical behaviour. Fairness of management,

which is related to justice and morality, is of grave concern to the Korean public (Ngyuen and Rowley 2015). Furthermore, despite the founder of POSCO having shown excellence in EM and the company winning awards for many years in Korea for its EM and its codes of conduct and ethics, they are not reflected the ethical decision-making process at the highest levels of the organization. Based on the indictments in November 2015 and new measures introduced in POSCO's March 2017 CEOs Forum, one will have to wait and see if these will have a positive effect within, not only POSCO domestically and overseas, but also within other Korean organizations whereby they will 'practice what they preach' as to EM and that their ethical leadership is truly ethical in nature. Time will tell if POSCO's global image will be restored through its new measures.

This research will contribute toward advancing knowledge in EM as it shows, despite decades of EM by a leading conglomerate in Korea, the personal decision-making by top management can have a negative impact on ethical management. Further research with the collection of empirical data will be beneficial for additional research in this area.

### Compliance with ethical standards

The authors declare that they have no conflict of interest.

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