

1.3 Compliance and Business Culture in China

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1.3.1 Introduction

1 Conventional wisdom on compliance in China for multinational corporations will likely begin by pointing out that doing business in China is both rewarding and challenging. On the one hand, China continues to lure investors, since the prospects of gaining access to the world's largest consumer base and fastest growing markets are an opportunity that hardly any Western CEO can afford to miss. On the other hand, both market entrants but also companies with decades-long China experience are becoming increasingly wary over the risks involved doing business there, especially in light of the recent and widely publicized series of prosecutions that suggest to some that foreign businesses will be held to higher standards than their local competitors. For Western companies in China, it is hardly surprising that compliance has become an increasingly urgent item for discussion. I have basically four points to make, which will inform the analyses that follow:

1. The main focus of any discussion of compliance in China should be respect for Chinese laws, which greatly improved during the last thirty years. For companies operating in China compliance primarily means following Chinese laws and regulations and communicating the firm's commitment clearly to its employees and stakeholders. Just as the past thirty years have witnessed significant progress in enacting laws often developed in dialogue with Western jurisprudence, so international businesses are advised to emphasize the convergences between Chinese laws and their own corporate codes and policies.

2. Although widespread fears are commonly expressed among foreign business people that succeeding in China's highly competitive business culture is rendered nearly impossible by a perceived lack of transparency, a penchant for back door dealings, including preferential treatment of state owned enterprises, in an atmosphere tainted not only by corruption but now also by a growing hostility to foreign businesses, media and NGOs, such fears should not determine the final verdict on whether to do business in China or how to do it. Overcoming such fears requires the implementation of effective compliance programs that challenge all parties to develop a critical understanding of Chinese customs and practices. This should enable them to accommodate their firm's procedures and regulations to what is morally sound and socially responsible in the distinctly different, yet quickly changing Chinese business environments.

3. Compliance with local norms and conventions in no way should be used as pretext for violating international law and the basic values enshrined in the company's code. Cultivating a proper understanding of different Chinese business cultures, their roots as well and their changing dynamics, should not require local operations to set aside their own values. Successful compliance programs in China must require all employees, whether Chinese or not, to internalize the firm's corporate culture as expressed in its code. A key challenge to moral leadership in China is

to sponsor on-going, rigorous training programs with a special concern to properly communicate the main requirements of the codes to all concerned stakeholders.

4. In order to be effective in the long run, compliance programs should not be seen as a form of indoctrination but as a process of developing a profound understanding of the local cultures, and making complex cultural adjustments that are mutually beneficial. This process does not mean going along with customs and behaviour patterns that violate one's own conscience. Nor does it require sacrificing sound business practices for an immediate "pay off". Though some short-term opportunities may be lost, companies should carefully consider that law enforcement is constantly improving in China. It is no longer the case that "making the quick buck" will ensure the survival and success of any business in China, foreign or domestic. The future belongs to those who learn how to build a solid reputation through cultivating lasting, trust based business relationships. Instead of regarding Chinese culture as a roadblock on the way toward this future, we need to recognize that the pursuit of profit unrestrained by either sound business judgment or compliance with the law is just as contrary to Chinese as it is to Western moral traditions. Besides, in China's rapidly developing appreciation of the benefits of compliance such attitudes also risk increasingly severe punishment, serious legal costs and damaged reputations. Attitudes such as excessive consume of alcohol, hiring of prostitutes, racist or sexist jokes etc. should be vehemently discouraged by any serious compliance program.

1.3.2 Compliance in China: Our Approach

Discussions of Compliance usually include two major aspects:

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a) Understanding the relevant laws, regulations and all regulatory requirements, commonly known as regulatory compliance; and

b) coordinating regulatory compliance with a company's corporate ethics and internal rules; as well as acknowledging the unwritten rules, the wider social norms and cultural expectations that bestow credibility upon the firm's local operations.

Compliance in China needs to be understood in a social environment marked by significant recent progress in the development of legal institutions, coupled with a still widely held scepticism among business people, that no one can rely on the letter of the law or a contract unless he or she also has cultivated "cosy" relationships especially with government officials.

In our understanding of compliance and its implementation in China, we believe that it ought to play a crucial role in the process of establishing a level playing field for business competition, in free and fair markets open to all. Within the context of the specific legal system in China, we

tend to agree with Wang Zhile and Jiang Heng who argue that the first priority of Corporate Social Responsibility (CSR) in China is compliance.¹ Without a strong commitment in China from businesses and other institutions and effective communication of that commitment to respect the rule of law, so runs the argument, the whole discourse on Corporate Social Responsibility will remain a dead letter.

- 3 In order to realize the paramount importance of compliance in the Chinese context, it is helpful to recall a number of widespread fallacies about how to succeed in business in China. Crucial to all of these is the mistaken notion that the fierce competitiveness of doing business in China does not allow for moral considerations or principles, however viable these may be in other countries. Here are just some of frequent prejudices about business cultures in China:

1. "When in Rome do like the Romans do": The unique cultural and political circumstances of doing business in China often require companies to compromise their global corporate codes and neglect their compliance responsibilities.

2. In order to be successful in China one should either completely ignore Chinese law or just pay lip service to it.

3. Everyone knows – or so it is said – that over the past 30 years China's rapid economic development has been accompanied by a noticeable absence of law and legal enforcement.

4. Good government connections based on a generous use of bribery is more important than compliance with the law. As long as good relations are maintained with the right government officials one will not be held accountable for breaking certain laws. And the reverse is also true – or so they say: if you insist upon compliance with China's laws and the best practices commonly supported by international business ethics, and thus refuse to bond with the right government officials, you will lose out and your business will not be sustainable.

Our approach involves setting the record straight about compliance in China so that the challenges to it can be faced with both moral clarity and managerial competence.

1.3.3 Challenges in Chinese Business Culture

- 4 Few doubt the fact that successful business in China, let alone managing a business operation there, significantly depends on understanding and responding correctly to Chinese business culture. It is thus essential to attain a basic understanding of some of the major concepts of Chinese culture and how these have developed over time and how they impact business culture today. An appropriate understanding of Chinese culture can

¹ Wang, Compliance. First Priority of Corporate Responsibilities, 2010.

lead to better understand the specific challenges to compliance in Chinese context. Therefore in this section we offer a sketch of some important points to keep in mind when attempting to cope with the distinctive challenges of Chinese business culture.

1.3.3.1 Contextualizing Chinese business culture

Chinese civilization and culture is among the oldest, continuously practiced in the world. Customs in contemporary China must be seen as a legacy of cultural paradigms that have remained remarkably stable during the last 5000 years.

1.3.3.1.1 Middle Kingdom mentality

Given the enduring success of Chinese culture it is hardly surprising that China has developed a strong sense of cultural pride. Very early Chinese viewed themselves as "the Middle", the "Central" Kingdom at the heart of the world with the Chinese Emperor being "a God on Earth". In the wake of foreign colonial aggression, the Communist Revolution and "Liberation" (1949) and China's subsequent opening up to the world after 1978 national pride has been resurgent. China's rapid rise has prompted many intellectuals to proclaim the 21st century as rightfully "the Chinese Century". It is not uncommon for foreign companies to encounter a certain resistance from their Chinese partners when they try to implement their corporate identity or values among their employees: not only is there a reluctance to internalize company values presented as "Western" or "global," but there also exists an assumption that such values are irrelevant. Chinese managers may insist that any foreigner coming to China has to undergo a long process of re-education before he can engage in meaningful discussions on how to change the way things are done (e.g. the particular way a Chinese company operates).

1.3.3.1.2 Law vs. trust

An equally important aspect is the age-old debate in Chinese philosophy on the trade-off between Law and Trust. The debate goes back to two of the most preeminent figures in Chinese philosophy: Confucius (551–479 BCE) and Mozi (470 –391 BCE). Confucius taught that it is more important to become a virtuous person² – that is to cultivate the right character traits and to have a special respect towards parents and other authorities, most importantly to become trustworthy – than simply to follow the laws. Mozi however countered that if preference were given to one's own family members, corruption would inevitably follow. Therefore he argued that there is a need for laws to make sure that the rights of each member of society will be respected. Good moral character must include respect

² Similar to Virtue Ethics in Western philosophy that was initially developed by Aristotle and re-developed in the 20th century.

for the law. The differences between Confucius and Mozi on the nature of a "morally refined person" « 君子 » ("Junzi"), certainly has had a profound impact in a variety of Asian cultures which have been influenced by Confucian traditions. Arguably, this difference helps account for the fact that China has long been characterized by a rule by law rather than a rule of law orientation – reaching its climax with the wilful changes of the law and regulations during the Cultural Revolution (1966–1976 CE).

Whoever is doing business in China, is challenged to balance these apparently contradictory aspirations: on one hand, cultivating business relationships based on trust is crucial to success; on the other hand, obeying the law should also be perceived as indispensable. In balancing these two, the government plays a vital role in ensuring that compliance is achieved. For example, the government must make sure that the required international safety standards are observed in factories. Any success that the government has in ensuring compliance in this area positively influences the investment climate and is likely to attract more Foreign Direct Investment. Conversely when government officials at all levels become complicit with firms in their disregard of compliance, they greatly undermine investor's confidence that business can be done in an orderly and predictable way.

1.3.3.1.3 Family and hierarchy

- 7 A perennial feature of Chinese culture is the importance given to family and the hierarchy that is meant to exist inside a family. Indeed, one of the central elements of Confucian thought centres around his observations and recommendations about the order and hierarchy that should exist in the family, and by extension, in society as a whole. Although respect for the elder generation was consistently undermined during the Cultural Revolution, since that time familial and hierarchical authority has been resurgent, especially as these extend to one's superiors in government, business, and other institutions. The recovery of Chinese family values has been prompted by the fact that family is the ultimate guarantee for trust. For one is significantly less likely to mistreat – or be mistreated by – one's family members than strangers. It is useful to note that to be considered "family" suggests the highest level of belonging, intimacy, and trust.

Such considerations are relevant for compliance management in China because, in spite of all the good that may come from acting consistently with family values, the mutual obligations family members acknowledge among themselves may sometimes contradict legal requirements. In light of the pervasiveness of patterns of creating trust and working relationships centered around families, compliance policies must insure that all the employees, and not just family members, enjoy the same rights. Enforcing such policies impartially will be particularly challenging when leaders of institutions use their power to place themselves and their families above the law and any duty of transparency. The Chinese model of "benevolent leadership" should be regarded as an authentic role mod-

el, only when it combines Mozi's insistence upon equal regard for all before the law with a Confucian concern to cultivate bonds of trust not only among family members but also in reference to each stakeholder.

1.3.3.1.4 "Guanxi"

The cultural aspect of Chinese business culture – that is perhaps the most difficult for foreign business professionals to understand and appreciate – is the omnipresent reliance on *guanxi* relationships, and their cultivation through some dubiously traditional practices, including lavish entertainment functions, expensive gift-giving and the prevalence of backroom deals that resist transparency and accountability. The term "*guanxi*" refers to the complex web of relationships related to one's family, wider clan, classmates, and work unit, based on a presumption of mutual trust and obligation. Such relationships undoubtedly serve as an efficient safety net especially in situations where the government for various reasons may not be able to provide support. This drive to acquire trustworthy relationships is particularly relevant in business, where trust is a prerequisite of getting into business together, rather than as a consequence of having done business together. It follows that *guanxi* not only provides personal security, but also may open the door to lucrative business opportunities that remain unavailable to others – who don't possess the connections that are so vital.³

Guanxi then describes both an individual's network of influential contacts he or she can call on as needed, as well as trustful relationships between two individuals. In marked contrast to Western relationships, there is often no difference between business and private relationships, there are no such notions such as "family and friend *guanxi*" distinguishable from "business *guanxi*" – these areas get easily mixed up. This not only reflects the importance of familial bonds in business, but also, once again, relates back to trust.

1.3.3.1.5 Entertainment

Roy Chua, a scholar from Harvard Business School, has shown that Chinese businesspeople, traditionally, place emotional trust over cognitive trust.⁴ His insight allows us to explore further how precisely such trust is achieved, since many practices in Chinese business culture are aimed at developing such emotional trust. This is the context for understanding the importance entertainment usually enjoys in Chinese business culture. The expense of business entertainments is justified in order to develop *guanxi*. Chinese business and professional people will invite each other to tea ceremonies, lavish banquets and engage in heavy alcohol consumption. Observers should not assume a purely hedonistic explanation of these

³ Chua, in: MIT Sloan Management Review, 2012.

⁴ Chua, in: MIT Sloan Management Review, 2012.

customs, since they are intended to develop a promising relationships, as individuals spend and enjoy together and prove their personal virtues as host or guest.⁵

Some executives may regard the cultivation of guanxi as a superficial, even mechanical way of doing business, as if getting drunk and spending excessively and demonstratively on lavish banquets will guarantee one's success. Compliance in this context means that all employees should be instructed on how to behave appropriately during banquets and what the company's policy is in honouring China's culture of hospitality.

1.3.3.1.6 Gift-giving culture

- 10 Analogous to the challenges involved in managing business entertainments, China's complex gift-giving culture involves the modernization of an age-old custom that can still be valued for expressing a desire to establish friendship. Therefore compliance policies that insist upon "Zero Tolerance" of gift-giving practices are likely to be misconstrued as indicative of barbarism or a basic lack of cultural understanding. Not every gift need be considered a priori as a bribe. However, hospitality may also at any time degenerate to excesses that are contrary to reasonable compliance standards and deeply harmful to one's health. Further below we will explain in detail how compliance must draw the line between what reasonably may be regarded as a legitimate gift and situations where the gift-giving is clearly intended as a bribe.

1.3.4 Compliance and Chinese Law

- 11 In light of my previous remarks challenging the widespread notion that there is a "rule by law but not rule of law" in China, the way is open to examine Chinese law and what real significance it has in shaping and regulating the social and economic realities in China. It goes without saying that any compliance activity is significantly shaped by
1. the content and context for interpreting specific laws, as well as
 2. the effectiveness of their application. Contrary to conventional wisdom, China has witnessed astonishing, yet widely unnoticed improvements in both of these areas.

The following section will demonstrate that after the Cultural Revolution,

- a. China has been on a steady path toward developing a legal system that is, at least in its theoretical content, highly compatible with West-

⁵ In fact, hospitality is characterized by a strong culture of reciprocity: both sides are enabled to give and take, symbolizing harmony and mutual dependability. However, the host is always in a position of power and may feel entitled to force his or her guests to drink heavily or engage in other acts which may be contrary to the standards of compliance.

ern legal systems (this is particularly true for China's Commercial Law) and that

- b. Compliance with or subsequent enforcement of the Law (especially the Commercial Law) has greatly improved. These trends are significant for MNCs (Multi National Cooperations) and their compliance strategies in China – indeed, these as well as the recent string of prosecutions many have faced on charges of corruption should serve as a wake-up call: if MNCs persist in the mistaken belief that the law is meaningless in China, their long-term security in China is certain to deteriorate.

1.3.4.1 *Development of the Chinese judicial system*

The status of law in China, its character and enforcement, remain a source of confusion for Western MNCs and their compliance management. Though the legal system was under serious attack during the Cultural Revolution, even afterward the development of legal institutions and effective law enforcement appears to have taken a back seat to economic growth, at least in the public eye. However, in the following section we hope to show that this understanding is partially incorrect: Although China is still recovering from the upheavals of the past and still has far to go in fulfilling international expectations for "the rule of law", over the past 30 years one positive development has gone largely unnoticed: in a period of rapid economic and social development, China has instituted a corpus of laws that frequently resemble or even imitate Western laws and legal structures. This section will consider specific Chinese laws and regulations in four key areas of compliance and CSR in order to inform readers of these developments, but also to illustrate the shortcomings (particularly in law enforcement) that are yet to be addressed.

China's remarkable recent progress, however, needs to be seen in the context of its overall history. This is no less true in the area of understanding the law and the challenges of compliance. During the Imperial period (221 BCE–1911 CE), the Middle Kingdom was governed centrally by a vast bureaucracy under the aegis of the Chinese Emperor and through extensive use of law. The word of the Emperor was the highest law and thus, at any time, could supersede any given law. Political power was thus more important than law, a classic case of what scholars today refer to as "rule by law". With the advent of Communist rule in 1949 CE, the imperial administrative system was transformed through the development of "revolutionary constitutions" that tended to invest all judicial power in the party and its officials. During the Cultural Revolution (1966–1976 CE) the process exhausted itself, and subsequently China turned away from its "anti-legal" stance: Prioritizing social order and economic improvement after Mao's death, the CCP's leadership realized the instrumental significance of law in giving people a sense of security against further abuses by powerful people and arbitrary policies. Thus, the beginning of the 30 year pro-

cess in which China would open up to the world was accompanied by an onset of new laws (from 1979) and the adoption of a new constitution in 1982.

1.3.4.2 30 years of legal reform

- 13 In a white paper on the "Efforts and Achievements in Promoting the Rule of Law", published by the State Council in 2008, the Chinese leadership claims that "especially during the 30 years since the introduction of the reform and opening-up policies, China has made tremendous achievements in promoting the rule of law in its great task of building socialism with Chinese characteristics".⁶ Whilst this assertion might seem unrealistic to many, a "reality check" reveals surprising insights: A study by the Konrad Adenauer Foundation (KAS), published in response to the PRC "White Book", showed that although the full realization of "the rule of law" might be far-fetched, over the 30 year reform period China has indeed delivered a significant legal corpus. With particular relevance to compliance, the KAS study notes that economic legislation almost completely covers all essential legal topics as they are found in Western legal systems.

If one considers the China's socio-economic reality when the era of reform was launched, economic progress depended on building confidence among both domestic actors and foreign investors, which in turn depended on development of relevant and reliable economic legislation. One of the first laws passed in the early reform period was the "Law on Chinese-Foreign Equity Joint Ventures" (July 1979)⁷. It is also worth noting that already in 1979 (and thus before the onset of China's dramatic economic catch-up) the environment was a major concern – the Environmental Protection Law⁸ was passed only two months later, although only for "trial implementation". Since that time, Chinese law reform has increasingly prioritized anti-corruption, environmental regulations and consumer protection legislation in response to pressure from China's populace – trends that cannot be ignored by any compliance department.

Although further legislation may be needed in each of these areas, and while law enforcement remains patchy, credit should be given to the government's record of implementing 229 laws, 600 government regulations and 7000 regional laws and regulations, while the total number of lawsuits in the PRC has increased to 6–7 million per year.⁹ Given the potential impact of these developments, and the increasing access to the courts afforded by the growth of the legal profession, a Chinese intellectual has aptly characterized many of China's laws as "sleeping beauties".¹⁰ Let us

⁶ Information Office of the State Council of the People's Republic of China (Ed.), *China's efforts and achievements in promoting the rule of law*, 2008, p.3.

⁷ *Law of the PRC on Chinese-Foreign Equity Joint Ventures*.

⁸ *Law of the PRC on Environment Protection*, 1979.

⁹ Schmitz/Kleinig, *China auf dem Weg zum Rechtsstaat?* 2008.

¹⁰ Wang, 'In the public interest' *China Daily*, (Beijing) 29 June 2009, 8.

turn then to examine the 5 areas where compliance and CSR most fruitfully may be converging.

1.3.4.3 *Anti-corruption law*

Since corruption by government officials is the most controversial and politically most dangerous issue in China today, the government has begun to take relevant disciplinary actions and, increasingly, to enact significant legislation. Reliance on party discipline has, so far however, taken precedent over relying on the law – although indications abound that this may soon change. Gan Yisheng, a former deputy chief of the party's Central Commission for Discipline Inspection, has pointed out that "we [the discipline body] have been using party discipline to regulate officials, but in the future we should try to regulate them based on law".¹¹ Indeed, the comments of senior officials, like Wang Qishan, the Central Commission's new head, suggest that the willingness to do so is spreading among top party echelons. Wang reported that "top discipline officials were accelerating the drafting of a national anti-corruption law".¹²

1.3.4.3.1 Development of existing legislation on corruption

Despite these promising signs, China does not yet have an anti-corruption law as such. Nevertheless, corruption has been dealt with indirectly through other laws. When China's first Criminal Code was published in 1979, it already contained references to corruption. The amendment of the Criminal Code in 1994, however, substantially extended the definition of corruption offenses.¹³

In addition to coverage by criminal law, corruption has also been addressed through the "Company Law" governing business in China¹⁴. Published in 1993, the law's statutes on corruption goes beyond the Criminal Code's focus on punishing (Government) bribe takers, to include bribe-paying companies. This is extremely relevant for compliance, since it indicates that much of the anti-corruption fight has shifted towards companies. Its promulgation in "Company Law" also means that corruption is now regarded as a civil offense. When examining this law, it is important to note that the National People's Congress has further strengthened the enforcement of this law by enacting the "Decision on Punishment over Crimes against Company Law" ("Decision"). This legislation mandates that bribe-paying business managers will receive the same prison sentences as corrupt government officials.

¹¹ *Zhai*, No sign of anti-corruption law as CPPCC convenes, South China Morning Post, 10.03.2013.

¹² *Zhai*, No sign of anti-corruption law as CPPCC convenes, South China Morning Post, 10.03.2013.

¹³ *Zhang*, Complying with Chinese Anti-Bribery Law, California Lawyer Magazine, January 2004.

¹⁴ *PRC Company Law*. 2005.

1.3.4.3.2 What the anti-corruption laws means for compliance

The Criminal Code

- 16 The approach to corruption established in the Criminal Code is particularly relevant for any MNC's compliance efforts in China. As the US-China counsel has pointed out to US businesses, the Chinese Criminal Code resembles that of other countries insofar as it has "jurisdiction over anyone 'who committed a crime within the territory of the People's Republic of China' ... (Article 6)"¹⁵. US, or any foreign entities for that matter, whether businesses or individuals, are thus subject to this regulation.

As with the other laws I will be discussing, the anti-corruption law risks creating problems of interpretation because of its lack of an exact definition of what specific offenses entail. The anti-corruption provision of the Criminal Code (Art. 389.1) defines bribery as "providing cash or property to state personnel for the purpose of seeking unjust benefits", and Art. 389.2 extends bribery to "providing a relatively large amount of money in the course of economic transactions against the State's regulations, or to providing state personnel kickbacks of commissions of any kind".¹⁶ The problem is that terms like "relatively large amounts of money" remain undefined. Effective compliance programs, however, at this point might make a positive contribution not only by referencing the law, but also by clarifying as a matter of company policy what such terms will mean.

The Company Law

- 17 Previously, I observed that Company Law also makes reference to corruption. According to Act. 203, "a foreign company is a foreign legal person and its branches established within Chinese territory do not have the status of Chinese legal persons".¹⁷ The advice paper by the US-China Counsel notes that "when a branch of a US company, its directors or officers commit a violation of anti-bribery provisions the foreign company will be held liable". As indicated above, the "Decision" advisory on sentencing those convicted of such offenses drastically extended the punishment that foreign and Chinese company employees may face for paying bribes.

1.3.4.3.3 Anti-corruption law enforcement

- 18 Despite shortcomings in the laws' clarity and despite the fact that implementation is hardly uniform throughout all provinces and ranks, data on enforcement trends are still impressive. Indeed, the Supreme People's

¹⁵ Zhang, *Complying with Chinese Anti-Bribery Law*, California Lawyer Magazine. January 2004, p.2.

¹⁶ Zhang, *Complying with Chinese Anti-Bribery Law*, California Lawyer Magazine. January 2004, p.2.

¹⁷ Zhang, *Complying with Chinese Anti-Bribery Law*, California Lawyer Magazine. January 2004, p.4.

Procurator reportedly investigated 32,567 cases involving 44,506 individuals for corruption or bribery offences related to official duties. These were not just low-level cases: 2,524 of the officials prosecuted held or involved county level official status, 198 were from a bureau or director level and seven had a significant provincial governor or ministerial level position.¹⁸ Compliance managers must understand that they put their companies at risk of criminal prosecution if they continue to operate as if China's anti-corruption laws do not apply to them.

1.3.4.4 Sexual harassment

Our second area for tracking the relationship between compliance and CSR is sexual harassment, an area of growing concern in a Chinese society rapidly developing beyond its patriarchal past. Although many NGOs are advocating the introduction of comprehensive legislation in this area, it is useful to learn that some legislation already exists. While this may encourage a few brave souls to seek redress of their grievances through lawsuits, China's own response to such efforts remains far too uncertain and complicated. 19

1.3.4.4.1 Development of sexual harassment law in China

Since the early 2000s, awareness of the right to and willingness to sue has been spreading among a few brave pioneers. However, with the absence of any reference to sexual harassment in the legislation until 2005, bringing a lawsuit to court has been difficult. The first sexual harassment case ever to go to court was in 2001, taking place in Xian. In the period between 2000 and 2006 there were just over 10 cases allowed to proceed to court – of which only 3 were successful. During this time the compensation awards ordered by the courts did not exceed 2000 RMB¹⁹. So far the only national legislation that directly mentions sexual harassment is the 2005 Law on the Protection of Women's Rights and Interests. However, even here the discussion of sexual harassment is confined to one article only, Article 40, which briefly states: "Sexual harassment against women is prohibited. The female victims shall have the right to file complaints with the units where they work and the departments concerned."²⁰ 20

This law has however been widely criticized for not providing sufficient teeth to enforce penalties against sexual harassment in a country where the practice is regarded as relatively widespread. Once again, the biggest weakness of the law consists in its failure to offer a comprehensive definition of what actually constitutes "sexual harassment" – a weakness that has made it notoriously difficult to win such cases. Indeed, the task of pro-

¹⁸ *The FCPA Blog China*, Anti-Corruption Handbook, Q4 2012, 2012.

¹⁹ *Srivastava*, Law and Policy Issues on Sexual Harassment in China, 2009.

²⁰ *Law on the Protection of Rights of Women's Rights and Interests* (April 3, 1993; amended Aug 28, 2005) (P.R.C.) §40.

viding a definition has been given to individual provinces. What little progress there has been started in 2007 with Shanghai's city council being the first administration region to promulgate a legal definition.²¹

Another enforcement problem has been the difficulty of determining what actually constitutes sufficient evidence of the crime. Zhang Jiangzhou, a judge from Beijing Haidian district, has pointed out that of the 10 women that have sued alleged sexual assaulters or employees in his court, only one won her case. "How to prove sexual harassment is the biggest difficulty faced by the victim, so they hide their experience and quit their jobs instead."²² The one rare case in which a defendant was actually sent to prison relied on an accidental videotaping of the harassment.

1.3.4.4.2 What sexual harassment laws mean for compliance

- 21 Over and above enforcing the existing legislation, companies have a moral duty to clearly define sexual harassment and implement effective compliance management consistent with these principles. The importance of this issue should be clear when one considers that according to a 2005 survey reported in state media, only 21 % of women said they had never faced sexual harassment. Another survey, by the Chinese Academy of Social Sciences, found that harassment was twice as prevalent in foreign or private enterprises as in state-owned enterprises, with 40 % of private employees reporting problems.²³ Clearly this should put compliance officers on alert, and should encourage them to enforce policies that already are common in other parts of the world, even if such vigilance is not yet required of them by Chinese law.

1.3.4.5 Environmental law

- 22 Our third area of concern is environmental law. Given the notoriety of China's pollution problems, many find it surprising that China actually has an abundance of laws regulating treatment of the environment. China.org.cn, a comprehensive resource on Chinese Law, lists 23 laws directly or indirectly related to the environment – a respectable 10% of the total of Chinese laws. Indeed, China's first legislation on the environment was published in 1979 on an experimental basis; the very year major legal re-

²¹ *China Daily*, Shanghai passes China's first sexual harassment law, 2007 – http://www.chinadaily.com.cn/china/2007-04/27/content_862173.htm (11.02.2014).

²² *China Daily* How to prove sexual harassment is the biggest difficulty faced by the victim, so they hide their experience and quit their jobs instead, 2013 – http://www.chinadaily.com.cn/china/2013-03/13/content_16303522.htm (11.02.2014).

²³ *Brangian*, Chinese man jailed in first sexual harassment case and under law, 2008 – <http://www.theguardian.com/world/2008/jul/17/china.gender> (11.02.2014).

form began²⁴. Since then, the number of environmental laws published is impressive (see table below).

Abbreviated Name of the Law	Date Adopted	Amendment
Prevention and Control of Water Pollution	1984	1996/2012
Environmental Protection Law	1989	2013
Water and Soil Conservation	1991	
Prevention and Control of Atmospheric Pollution	1995	2000
Prevention and Control of Environmental Pollution by Solid Waste	1995	2000
Coal Industry	1996	
Conserving Energy	1997	

1.3.4.5.1 Compliance and environmental laws

Despite the ample existence of such laws, environmental degradation obviously remains an enormous problem. Indeed, the mere existence of judicial institutions hardly guarantees that such a problem can be solved. As the China Daily has pointed out, while China has over 130 environmental tribunals and similar institutions (half of the world's total), the number of environmental cases admitted is disappointing.²⁵ During a recent forum on environmental laws by the China Institute of Applied Jurisprudence of the Supreme People's Court, some astonishing number were presented: Of the more than 300,000 letters received between 2006–2010 that raised environmental complaints, only 1% have led to court cases. Similarly, a retired official of the Environment Ministry has remarked that less than 1% of actual environmental disputes are resolved by standard judicial procedures.²⁶ Such statistics point to problems of implementation and enforcement that parallel what we have already seen with other issues.

As the case of the Environmental Protection Law shows, this law adopted in 1989 was meant to be amended and significantly sharpened – not least because in the 24 years since its existence, the state of China's environment has deteriorated significantly. The amendment process, however, has been delayed several times for reasons that are highly unusual for China's legislative process: When the first draft for the amendment was made available for public comments in August 2012, it attracted 11748

²⁴ *The Environmental Protection Law of the PRC, 1979*, State Council Information Office.

²⁵ *China Daily*, Environmental courts failing to prosecute cases, 2013 – http://www.chinadaily.com.cn/china/2013-08/14/content_16894389.htm (11.02.2014).

²⁶ *China Daily*, Environmental courts failing to prosecute cases, 2013 – http://www.chinadaily.com.cn/china/2013-08/14/content_16894389.htm (11.02.2014).

comments within a month, mostly criticizing its mildness and lack of fundamental change²⁷. In its second draft, environmental protection has been defined as a basic state policy for the first time, and the government's protection responsibilities (notably including public accountability) have been increased. Realizing the judiciary's incapacity and subsequent implementation problems, the new draft also gives four major stakeholders (local governments, the local environmental protection authorities, enterprises and the public) indispensable roles and responsibilities in protecting the environment.

MNCs thus should be aware of the fact that "until recently, it appeared that China would employ its judiciary to solve a deepening environmental crisis. However, the Chinese government ... is moving away from the rule of law towards a tighter embrace of political solutions."²⁸ Indeed, as Golding, continues to point out in his article "Incentives for Change: China's Cadre System applied to Water Quality", "the Chinese government has struggled to enforce environmental law, due in part to local protectionism". He goes on to show that "in an attempt to overcome local protectionism, the 2008 Law on the Prevention and Control of Water Pollution uses the cadre system to incentivise local officials to enforce national water quality standards".²⁹ This trend is of enormous relevance for refining a company's compliance policy, since incentivising officials in this way will mean, on the one hand, that they will be scrutinized much more intensively than before, while on the other hand, their accountability will not be mandated through existing environmental law. Even so, the legal principles should not be set aside, even though they may not always be upheld by the judiciary itself.

While China's laws often offer a good impression of what is expected of MNCs operating there, the new enforcement approach by the government means that companies need to develop compliance beyond simply complying with the law and the environmental standards that it sets forth. As local officials are increasingly pressured to limit environmental deterioration, companies are well advised to work in that same direction and align local officials' targets with their own. Should they fail to do so, they are likely to become subject to sanctions from various government agencies, perhaps even regardless of their compliance with all relevant laws.

1.3.4.6 Trends in law-enforcement – and their implications for MNCs compliance

- 24 Recent headlines dramatizing the Chinese governments' crackdown on pharmaceutical companies, including many Western MNCs, have given executives across many sectors strong second thoughts about operating in

²⁷ Wang Yiqing, Steps forward and a step back 2013 – http://www.china.org.cn/opinion/2013-08/16/content_29736577.htm (11.02.2014).

²⁸ Golding, in: Pacific Rim Law & Policy Journal, 2011, 20(2), 399.

²⁹ Golding, in: Pacific Rim Law & Policy Journal, 2011, 20(2), 399.

China. They fear that they are being singled out for engaging in business practices they have copied from their Chinese competitors (if only to a reduced extent), without which they think they cannot survive. Their precarious situation, they think, is also highlighted by the fact that they might increasingly be held responsible for acts of their local employees that they themselves discourage. As Bruno Gensberger, president of the European Chamber of Commerce's pharmaceutical working group, observed, "foreign companies that are most serious about SOPs (Standard Operating Procedures) have been the most investigated and the most discriminated against".³⁰

However, such fears and grievances do not necessarily give us the full picture nor are they likely to lead to a successful compliance strategy or its management. If, instead, one achieves proper perspective on the development of China's legal system, the recent enforcement of Chinese law should not at all be surprising. Rather than being seen as an unfair disadvantage to foreign firms (protectionism) they should be seen as the beginning of a bigger shakeup – recent cases are just the tip of an iceberg – that has and will apply to Chinese firms just as much as it will to Western ones. However, it is not hard to realize why the legal progress that has preceded the crackdowns has been overlooked. As legal institutions were slowly improving unnoticed in the background, everyone's attention was focused on China's apparent prioritization of economic development over everything else. Western firms however, have little cause to complain about receiving so much unwanted attention. The Chinese government's increasing toughness has come as much as a surprise to domestic firms as it has for MNCs. So why should MNCs expect to receive a warning note before their domestic competitors?

1.3.5 Implementation of Compliance Policies

1.3.5.1 Inculturation

Inculturation as a practical principle for implementing effective compliance programs builds on a genuinely self-critical understanding of a culture, instead of blind acceptance of superficial preconceptions about the local culture. Evidence seems to suggest that understanding the processes of inculturation as they relate to business has been a key aspect in the development of more successful and sustainable companies in China.³¹

The term, inculturation, originated in the context of the Catholic Church's mission strategy that delineated the process of adjusting the institution and its customs to different local cultures. While maintaining its universal values, "in-culturation" indicates the complex process of an in-

³⁰ *The Big-Story*, Bayer AG comes under investigation in China, 2013 – <http://big-story.ap.org/article/bayer-ag-comes-under-investigation-china> (22.09.2013).

³¹ *Hanson/Rothlin*, Taking your codes to china. Dimensions of teaching business ethics in Asia, 2013, pp. 77–89.

stitution entering into local cultures in a spirit of profound respect. Inculturation develops between two poles: on one side to reconnect to the different traditions of the institution ("*Ressourcement*" in French) and on the other side to adapt to an ever-changing modern global world ("*Aggiornamento*" in Italian). Along similar lines companies doing business in China also aim to balance universal standards with the rich variety of local customs and standards. Combining global consistency with local sensitivity seems to be relevant in a country like China, given vivid memories of foreign aggression and the strong and wide spread patriotism that it has provoked.

The process of inculturation is also evident in the development of Asian philosophies where, according to Daryl Koehn, there is an ongoing interplay between global ethics and local insights³². Inculturation enables those involved in the process both to deepen the understanding of global principles and to integrate them effectively in light of local conditions. However, a main challenge for extending inculturation to the challenges of compliance policy is to enhance a sense of the law, so that it is perceived not as an obstacle for business, but rather a condition for fair competition. Finding a local rule that responds to the principle to be inculturated may be the most effective way forward.³³

1.3.5.2 Application to key compliance problems

1.3.5.2.1 Traps of the hospitality and gift-giving culture

- 26 As described above, the original purpose of "*guanxi*" is to build trust based on a complex web of interpersonal relationships. *Guanxi* is certainly at the core of successful and sustainable business in China. However the meaningful gift-giving culture traditionally sustaining *guanxi* may sometimes be overrun by meaningless practices of lavish excess.

Inculturation in this case would mean developing a proper understanding of *guanxi* and the culture of gift giving. Inculturation thus can help foreign companies identify the elements of the *guanxi* practice that may advance its standards and good practices, but reject those that clearly violate not only their principles but also Chinese law.

Roy Chua, a scholar of the Harvard Business School, for example, has demonstrated³⁴ that not practicing proper inculturation and ignoring compliance standards in order to engage in immoral and questionable practices that in fact are disrespectful of local cultures has often been counterproductive for Western players in China. Indeed, Chua's research has convincingly shown that companies practicing *guanxi* devoid of a sincere interest in cultivating trusted business relationships end up with a

³² Koehn, Local insights, global ethics for business, 2001.

³³ Hanson/Rothlin, Taking your codes to china. Dimensions of teaching business ethics in Asia, 2013, pp. 77–89.

³⁴ Chua, in: MIT Sloan Management Review, 2012.

bad reputation among potential Chinese partners, as they are seen as too fun-loving and not serious about business.

Nevertheless, it cannot be denied that the corrosive effects of rapid economic and social development have often hollowed out China's traditional gift-giving and hospitality culture. Significant portions of the Chinese business community, varying by province, simply expect lavish gifts and questionable entertainments, as a condition for doing business. The symbolic power of a gift, especially in China, is by no means confined to its price tag. In fact, the strength of the relationship may not be expressed by a high price, but by the fact that it demonstrates the giver's benevolent familiarity with the personal tastes of the recipient. Though a rethinking of gift-giving policies at first may be resisted, companies might actually gain edge by prioritizing innovation over blunt luxury. Thus, setting strict limit not only on the costs of a gift or of hospitality and entertainment for a certain occasion, but also on the kind of entertainments offered is practicable and strongly advisable. Rather than avoiding the vague term, "nominal gifts", effective compliance policy may require setting clear price tags for gifts.

1.3.5.2.2 Cultivating good government *guanxi* vs. simple bribery

Cynics may question the importance of gift-giving's traditional meaning, particularly in the case of notoriously underpaid government officials. While it may be true that focusing on building good relations will not please corrupt officials who may grant a benefit to the bidder who pays him the highest, compliance policies should not be calibrated to the demands of corrupt officials. In light of recent prosecutions for corruption, especially those against foreign enterprises as described above, it may be more prudent to relinquish short-term benefits for the sake of an enterprise's long-term success in China. Foreign businesses may put themselves at risk when they align themselves on the wrong side of Chinese history. 27

When managing government relations, the firm's policies should be particularly oriented to ensuring compliance with the Chinese law by all its employees. By contrast, since managing *guanxi* with business partners is more interactive, compliance policies informed by inculturation can have a constructive impact on how the firm does business, e.g. reinterpreting its gift-giving culture to business partners. The distinguishing factors here are the different types of dependency involving government officials rather business partners, and the remarkably low government pay scales. Since government officials are much more dependent on expensive gifts than the business executives, a realistic compliance policy on gift-giving needs to clearly avoid making improper concessions in dealing with officials who violate Chinese law. Managing compliance must be alert to the possibility that employees will be tempted to violate directions from the top in order to gain short-term commercial advantages, either for them-

selves or for the company's own bottom line. Particularly challenging is the fact that the company's incentive scheme might unintentionally motivate individual employees to engage in illicit activities. If companies are serious about effective compliance management in China today, they are well advised to continuously review and realign their incentive policies.

1.3.5.3 Suggestions for implementing codes

- 28 As noted above, ensuring that employees with diverse cultural backgrounds fully respect and internalize the company code and all legal requirements is an enormous challenge for MNCs in China. It thus may be necessary to give special scrutiny to the communication strategy used when introducing (and reminding employees of) the corporate code and its application.

Research published by Kirk Hanson and me³⁵ showed that companies face special challenges convincing their employees of a corporate code's relevance when relying on communication methods that might be typical in the West. Obviously, merely circulating a booklet or an email with the code attached is hardly sufficient. Rather, getting the employees to take ownership of the corporate code and attendant regulations by making its introduction a significant task on the way toward achieving the business's goals. In order to ensure that employees take the code and regulations to heart, it is crucial that considerable time be allowed for discussion, dealing with objections, and further clarification – and all with significant input from employees at all levels. While offering such input and raising objections might once have been considered as resistance or disobedience, especially in China, it is actually the right channel to ensure that the code is properly understood, so long as it is done in a way that makes sufficient use of Chinese concepts.

Introducing the company code is likely to be more effective, if line officers are instructed to convey it to the employees whom they supervise – provided, of course, that they themselves have already been convinced. Given the importance of hierarchy in China, the most senior executive of an institution and, often more importantly, the most senior Chinese executive must publicly demonstrate their honest and complete support for the code. In an extension of the principle of hierarchy, Hanson and I discovered that aligning one's code to Chinese moral concepts and, often more importantly, current key political slogans and campaign concepts as propagated by China's leadership, may enable significant breakthroughs in making one's employees understand and enact the corporate code and Chinese regulations. There is no doubt that the strong commitment of China's present leadership to fight against corruption will have a positive impact on implementing best practices.

³⁵ Hanson/Rothlin, *Taking your codes to china. Dimensions of teaching business ethics in Asia*, 2013, pp. 77–89.

By communicating codes, regulations and other standards effectively from the beginning, one can minimize the initial cultural resistance against “foreign” culture or “Western moral lecturing”. It is important to have constant recourse to the fact, however subtly suggested, that the code is in line with the requirements of Chinese law. Furthermore, company-wide discussions of key principles and regulations ensure that no one can claim that she was unaware of the existence of these regulations. The dialogue process needs to be enhanced by the kind of strong executive leadership that makes sure that codes and regulations are understood as a commitment of the entire firm. Particular attention needs to be given for setting clear guidelines for gifts and entertainments.

The work that I did with Hanson and my own experience conducting management seminars and workshops in China has allowed one key message to rise above the others: the importance of training.³⁶ Often companies do not really see any added value in engaging in elaborate training seminars and consider compliance as merely an exercise in ticking boxes on a compliance letter. With such an attitude it is no wonder that the understanding of codes and best practices may remain superficial or altogether non-existent. In order to be effective the code must be communicated at all levels of a corporation. Such communication must provide opportunities for extended discussion with employees about what specific responses and behaviour patterns are expected from them in difficult situations. Indeed, the use of realistic scenarios and case studies is a crucial way to make employees truly understand and adopt the company's code. Based on what we've said about it here, a useful place to begin might be a realistic case study on how to cope with demands for bribes and other illicit favours.

1.3.5.4 *Respecting the central role of the government*

For executives with a Western background it may be difficult to comprehend how central and decisive the role of the Chinese government has in any compliance implementation. As pointed out above, law enforcement is to a significant extent complemented by government sanctions that still work outside the existing framework of laws and regulations (e.g. see legal section on anti-corruption and environmental issues above). Compliance thus requires strong cooperation with various government agencies on all sorts of matters that in the West might be considered as part of Corporate Social Responsibility. Aligning the firm's own interests and objectives with the government's policy goals (e.g. on environmental pollution) is thus conducive to ensure that one is not prosecuted because of misunderstandings or technical violations of such policy. Cooperation also ensures that Western MNCs find out about changes in the governments' ex-

³⁶ *Sekerka, Ethics Training in Action, An Examination of Issues, Techniques, and Development, 2013.*

pectations more quickly and securely than a mere adherence to all new laws would allow.

1.3.5.5 *The case of whistleblowing*

- 30 Contemporary efforts in compliance are increasingly inseparable from whistleblowing. As Schulz has pointed out, "modern compliance systems do not simply consist of ethical guidelines or institution building that would enable whistleblowing, but combine ethical guidelines with an obligation to whistleblow".³⁷ Indeed, especially in the Chinese context, it is important to stress the difference between "whistleblowing" as an internal mechanism for seeking truth and facilitating improvement within an organization and as an external process that involves outside parties, most importantly the news media and the blogosphere as well as the government, and serves as a last resort to correct major deficiencies.

1.3.5.5.1 Common reservations about Whistleblowing

- 31 The problems that in-house whistleblowing has encountered in Germany reveal some general difficulties, which undoubtedly are relevant in China. According to a recent study by PricewaterhouseCoopers, only 34% of big German companies have implemented whistleblowing policies and procedures and, of those that have not, only 10% want to implement one, while 76% think it extremely unlikely that they will.³⁸ When considering the reasons usually given for this reluctance, one can encounter reservations that resonate across different cultures. Understandably, fears of promoting a culture of mistrust (57%), encouraging internal espionage (55%), as well as general concerns about operational disturbances (52%) are the main reasons cited for, why many German companies remain reluctant to introduce whistleblowing policies and procedures.

Although no comparable figures exist for Chinese companies, these concerns are all likely to echo strongly in China: especially in joint ventures, or foreign owned enterprises, where management and employees alike struggle hard to build trust. Indeed, lower-level employees, under the cover of mere gossiping, may frequently be tempted to report on their colleagues to higher authorities. It is imperative to prevent misinterpretation or even abuse of whistleblowing, by distinguishing it from such petty activities, and to communicate that whistleblowing is protected in Chinese law in order to enhance the rights of the employees. Whenever there is evidence of a violation of Chinese law the whistleblower is entitled to report it to an ombudsman designated by the Board. More than just a mere "ethical hotline" this process safeguards the confidentiality of the

³⁷ Schulz, *Ethikrichtlinien und Whistleblowing: Arbeitsrechtliche Aspekte der Einführung eines Compliance-Systems*, 2010, p. 29.

³⁸ *PricewaterhouseCoopers/Martin-Luther-Universität, H. (Eds.), Compliance und Unternehmenskultur – zur aktuellen Situation in deutschen Großunternehmen*, 2010, p.32.

whistleblower and entitles a competent person appointed by the Board to make an investigation into the matter. Great care should be given in training seminars to explain the true purpose of whistleblowing.

1.3.6 Conclusion

Compliance may play a crucial role in advancing legitimate business interests and enhancing a fair business environment when it is conceived comprehensively as an ongoing process intended to highlight the relevance of China's laws as well as the companies' own codes and regulations, while constantly engaging in a dialogue with the complex cultural, socio-political, and economic elements in a highly competitive business environment. 32

The government's prominent role in this process must be acknowledged at all levels in order to create and protect a legally reliable level playing field for all companies doing business in China. Such a positive engagement with the government will enable companies to develop effective compliance programs in the key areas of resisting corruption, ensuring healthy and safe working conditions, advancing consumer protection and avoiding any environmental harm. Conceived in such a way, compliance will play a decisive role when it comes to ensure the rights and to uphold the obligations of all the stakeholders.

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