

## ETHICAL ASPECTS OF DECISION-MAKING IN AGRI-FOOD ENTERPRISES

Patricia RAȚIU<sup>1</sup>  
Maria MORTAN<sup>2</sup>

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### ABSTRACT

*Ethical decisions making in the agri-food sector is a topic of multiple dimensions. In the present paper we have choose to focus on aspects regarding ethical and unethical activities of agri-food enterprises in relation with its stakeholders.*

*Based on literature review we highlight the role of ethics in decision making and then the objective was to link the body of literature on business ethics to the food sector, and especially to the agri-food enterprises. Taking into account that the food supply chain connects important and diverse actors the aim of the present paper is to provide an overview on the impact of ethical and unethical decisions making by agri-food companies on selected stakeholders.*

*Findings of the paper show that among the Romanian agri-food enterprises, few are concerned to integrate ethical decision in their activities and act responsible. Also along the entire food supply chain individual consumers and producers are the most exposed and affected by unfair practices.*

*The article concludes that for the agri-food sector, which is dependent on natural, human and physical resources, responsible innovation and ethical behaviour should be increasingly seen by firms, as a corporate and strategic necessity to ensure long-term sustainability.*

**KEY WORDS:** *agri-food enterprises, ethical behaviour, sustainable food chain, stakeholders.*

**JEL CLASSIFICATION:** *M14, M39, Q10*

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### 1. INTRODUCTION

In recent years we have witnessed to a disorder in the whole society, due to overturning values which had a negative effect on businesses in the agro-food sector. We believe that in this context, a proper functioning of the food supply chain should takes into consideration the ethical issues in the relationships with a wide diversity of stakeholders like farmers, food processors, traders, consumers, employees, community and last but not least the environment. These relationships are often fraught with difficulties which hold back the full potential and competitiveness of the chain. Therefore within this paper we intend to promote sustainable relationships between stakeholders in the food supply chain by analyzing the ethical decision making and the consequences that might arise from unethical behaviour in the market place.

Agri-food sector is a vital driving force for the EU economy covering over 17 million enterprises in agriculture, food processing industry and related services sector (the distribution sectors). The food supply chain connects these three important sectors of the European economy that together make more than 5% of European value-added and 7% of employment. (COM (2009) 591). Moreover, its performance has direct consequences for all consumers, since food represents 16% of European households' expenditures (COM (2009) 591). The functioning of the food supply chain takes on increased importance in the path towards recovery from the current economic and financial crisis.

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<sup>1</sup> Babeș-Bolyai University, Faculty of Economics and Business Administration, Romania, e-mail: patricia.ratiu@econ.ubbcluj.ro

<sup>2</sup> Babeș-Bolyai University, Faculty of Economics and Business Administration, Romania, e-mail: maria.mortan@econ.ubbcluj.ro

The current economic crisis is having a very significant impact on the sector by exerting considerable pressure on agricultural prices and income, notably in the dairy and livestock sectors. (COM (2009) 591).

Agriculture and food industry are among the most important sectors that should ensure competitiveness in the Romanian economy. In Romania the food industry sector includes: milk and dairy products, meat and meat products, vegetables, fruits and potatoes, wine, grain and oilseeds. Since the Romanian agribusiness is characterized – in production area - by a large number of small farms not commercial, our research regarding ethics decisions will be focused from the point of view of processing company.

In our opinion, in an industry with such a high degree of exposure to consumers, ethical decision in relation with stakeholders are very important because a company whose food products are contaminated, or whose suppliers exploit child labour, can suffer serious reputational damage.

## 2. LITERATURE REVIEW

Ethical issues are nowadays more important than ever, in a world driven generally by money and power, the ethical rules are essential to obtain not only financial performance but also social performance and to keep good relation with all business partners. Ethical behavior in business not have to be demonstrated; if we accept that economic life is part of our society, without which we could not exist and that we cannot live without certain rules and moral principles, means that an economic system cannot last and cannot bring welfare in society if it is not based on a practice of ethics.

Ethics management is a field of applied study and within an organization is primarily aimed at the moral conduct of managers, concepts, aspirations, skills, principles on which they take decisions in everyday activities. In some cases ethics exceeds the legal, because the latter cannot cover all situations that affect moral rules when conducting business.

Ethical behavior of an organization is given by a number of factors: the level of development of the country, leadership style practiced organizational culture, ethical codes, its mission, the results, the environment in which it operates, competition, society pressures (Nițulescu, 2010:48).

Agri-business ethical decisions depend largely on leadership ability of the managers, their qualities and values, the vision they have on obtaining and maintaining a favorable position in the market. Managers of agri-food enterprises often face situations that raise ethical issues, being forced to choose between acting according to the principles and moral values recognized by society or in agreement with the direct and immediate self interest. It is obvious that not all managers have well-developed sense of morality and that is why companies should adopt policies, standards and codes of ethics at the organization level to validate claims of sustainability. It is widely argued that also agri-food enterprises need to define their roles in society and apply social and ethical standards to their business. (Marotta & Nazzaro, 2012:671).

Scandals on rotten meat, dioxin or inadequate labour conditions have gained considerable media attention and put the reputation of the whole sector at risk. (Hartman, 2011:305). We consider that adoption of ethical behavior in business help to strengthen the company's reputation and avoid its vulnerability in the public. Institutionalization of ethics within the organization can be done by building a culture by rules, customs, and practices. According to Nițulescu, (2010:35) the way to realize the rules of ethics is represented by codes, values and moral standards developed by various professional organizations, businesses and consumer associations.

A manager may unwittingly encourage unethical practices, exerting too much pressure to achieve goals that are perceived as too difficult by employees. A manager's sphere of action comprises a vast circle of decisions often manifested in the activities of organizations, in all management functions. According to some authors (Emilian al., 2004:8), ethics must accompany the whole process of decision making in all its stages: identify and correct definition of decision problem, decision establishing criteria and objectives, analyze the possible decision alternatives, choosing the

optimal. Gelinier Octave (1991), a known management theorist, proposes implementing a "test of ethics" with three questions:

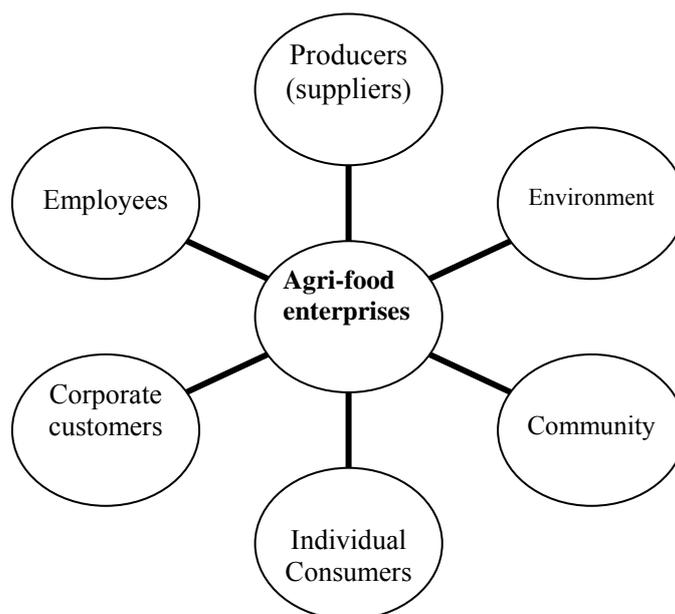
1. Is it legal? This decision will violate the law or internal rules of the company?
2. This decision is fair to all stakeholders, both in the short and long term
3. I will feel proud of this decision? But, if my family would know the decision? But, if it were made public?

Business ethics is useful, at least to the extent that aims to streamline the process of decision making and justify the behavior rules that guiding relations between economic agents.

### 3. ETHICAL AND UNETHICAL DECISIONS IN AGRI-FOOD ENTREPRISES. THE IMPACT ON THE STAKEHOLDERS

Fundamental relationship that focuses on the highest part of business ethics issues is actually a favorable balance between the economic performance of the company, measured in revenues, costs, profits or liabilities and its social performance more difficult to estimate, represented by compliance obligations to employees, customers, creditors, suppliers, distributors or community and environment.

Our research started from the premise that the ethical or unethical activities held by agri-food enterprises and how to assume their management social responsibility, turn on employees, customers, business partners, the community and the natural environment, as we can see in figure 1.



**Figure 1: The stakeholders of an agri-food enterprises**

*Source: authors' conception*

Often food companies face difficult decisions about providing an optimal balance between satisfying consumer needs and the affirmation of social responsibility by adopting an ethical behavior in relation to these. However, in the 'real' market situation responsible conduct of firms is in most cases not transparent and observable, and thus is a so-called hidden quality for stakeholders. Whether a farmer, food processor or retailer really incorporates ethical issues in its management strategies needs to be 'trusted', for example, by consumers. (Hartman, 2011:309) In this respect not only the visibility and accessibility of the information for stakeholders, but also its credibility is an issue.

In practice, socially responsible actions and ethical decisions making are highly beneficial because positively influence the entire food supply chain.

Next we purpose to analyze the ethical and unethical behavior of agri-food enterprises reported particularly to their stakeholders and implicit to elements of the marketing mix: product, price, distribution, promotion.

### **3.1. Producers**

Within the food supply chain, bargaining power and potentially unfair trading practices are a common occurrence and this issue was flagged as a serious concern by stakeholders (COM (2009) 591). This imbalance in bargaining power may occur when a food processor, larger and more powerful impose contractual arrangements to their advantage to a small farms. Such practices may occur at every link of the chain and include, for example, late payments, unilateral changes in contracts, ad-hoc changes to contractual terms, upfront payments as entry fees to negotiations. Within processed food supply chains, on the one hand small food processors are contracting with usually large retailers that are often their only channel for accessing the market. On the other hand, large multinational food producers may also have important bargaining power as they offer branded products that retailers cannot do without. Contractual imbalances associated with unequal bargaining power have a negative impact on the competitiveness of the food supply chain as smaller but efficient actors may be obliged to operate under reduced profitability, limiting their ability and incentives to invest in improved product quality and innovation of production processes (COM (2009) 591). According to FranceAgrimer in the case of UHT milk, the share price paid to producer from the final consumer price of milk, decreased from 32.2% to 25.9% during 2005-2009 which obviously harmful the producers' ability to invest (COM (2013) 37).

A better awareness of contractual rights and stronger action against unfair contractual practices could contribute to preventing these drawbacks since actors with limited bargaining power suffer from a lack of information on their rights. Moreover, they may hesitate to contest contract clauses for fear of losing the contract altogether.

For example, in Romanian agri-food sector, aflatoxin scandal that took place in March 2013, resulted in continuous cheaper milk. In this context, agri-food enterprises behaved unethically in relation to producers, having an ace up your sleeve when negotiating the purchase price of milk. Taking advantage of the situation they called discounts up to 30% on the purchase price of milk.

A question that may arise refers to what sustainability means for a processor of dairy products in relation to his producers or suppliers? For example in Danone factory from Bucharest, over 90% of the milk used comes from local farms and therefore, Danone constantly invests in increasing local production capacity. There are two ongoing projects, and the best known is "Go West" launched since 2006 and which provide support to farmers for business development. There are different levels of support from milk payment in advance for 12 months (without interest) to delivery of over 3,000 cows and 20 new milking equipments at competitive prices. The results are visible: total productivity in farms has increased by 120,000 tons of milk in seven years. (<http://www.responsabilitatesociala.ro>). We believe that concerns for rights and issues of those who produce the ingredients they need is an evidence of ethical behavior of agri-food enterprises.

Another ethical behaviour of agri-food enterprise in relation with their producers refers to the fact that they would not accept raw materials in the production process if these are contaminated, outside acceptable limits. According to Ionete (2005) this decision is critical to the production takes place in appropriate conditions of hygiene and manufacturing and to food be protected from sources of contamination and potential hazards that would make it unfit for consumption.

### **3.2. Employees**

Employees are the stakeholder group most closely integrated into the company. Several studies (Hartmann, 2011:308) investigate the impact of firms' conduct on its workforce and find a positive and in some cases sizeable relationship between employees' perception of ethical behaviour on the

one hand and firm's reputation as perceived by employees, their organizational identification, commitment, perceived work role, work satisfaction and their intention to stay in the company on the other hand.

In summary, research results are supportive of the view that responsible firm behaviour may not only keep employees motivated and help to increase their loyalty but potential employees may be drawn to firms with a good reputation allowing it to select the best. Thus, we support the view that acting socially responsible increases a firm's ability to successfully compete in the market. Given the high level of competition in the food sector this is of considerable relevance for food companies to act ethically in relation with their employees. Furthermore if employees feel that they are not treated right by the management of the company, they are more likely to act the same in the relation with customers. It is understood that therefore unethical behavior, the loss is much higher than outright sale of products and cost of attracting new customers is much higher than that of maintaining current customers.

### **3.3. Consumers (individual consumers and corporate customers)**

Consumers are increasingly concerned about ethical issues related to food production, processing and consumption, including health, environmental protection, animal welfare, working conditions and sustainability. They are bringing these considerations more and more into their everyday choices. The effects of buyer power abuse are now so pervasive in food supply chains that they may well influence all these areas that concern consumers. (Consumers International, 2012:16).

We consider that consumers can play a critical role in creating a sustainable food system. Through their purchases, they send strong messages to producers, retailers and others in the system about what they think is important. Food cost and nutritional quality have always influenced consumer choices. The challenge now is to find strategies that broaden consumer perspectives, so that environmental quality, resource use, and social equity issues are also considered in shopping decisions. At the same time, new policies and institutions must be created to enable producers using sustainable practices to market their goods to a wider public, increasing mutual trust, and encouraging a long-term view of food production, distribution and consumption.

In fact, critical and responsible consumers have gone beyond simple utilitarian goals as they evaluate other factors such as, the impact of production upon the environment and community, in addition to price and quality of goods/products. (Marrota & Nazzaro, 2012:670).

#### *Ethical decisions in product policy*

A part of the marketing mix is product policy setting, and in this area can arise various problems regarding compliance or ethics violation. In the context of product policy agri-food enterprises ignore the requirements of ethics and act deliberately in a way that leads consumers to reach false conclusions.

For example, packaging can mislead consumers when dimensions are significantly larger than content and it is not necessary to maintain the product in good condition. Such a technique is used to make the product appear larger and for the producer to gain more space at the point sale. Also, packaging must not involve excessive expense that not justify the amount offered and lead to price increases. (Vrânceanu, 2007:29).

Perhaps the most elusive area of product policy setting, in terms of respect for professional ethics is product positioning and representation of features that make a difference in relation to competitors. There are many situations in which the products are presented ambiguously what can cause a number of misconceptions about the real benefits of the product.

For example the label of food products is required to contain correct information on its characteristics, on the indications and contraindications for use, on the country of origin. Regarding this last point, there is likely to mislead the consumer when parts of the product were made in different countries. We believe that the country of origin is important because it influences how it is perceived quality by the consumers.

Ethics evaluation is required when is highlighted on the packaging of a product that it does not contain a specific ingredient that may affect the environment or health, but contains other elements that have a similar effect. Also, in the case of agri-food products misleading information may appear on the calories or fat content, for example "contains 0% fat" when in reality the fat content is higher. Another ethical issue is to focus on certain ecological attributes of the product. For example, an agri-food company can focus on products that do not contain a certain substance which is not very good for health, but in reality contain food additives that may have similar consequences.

One of the areas of interest of ethical decisions in product policy is represented by it safe. Food safety involves ensuring food hygiene throughout the entire process from obtaining raw materials to final consumer. (Catoiu, et al., 2010:8). According to other authors (Cauvian & Young, 2004), food safety also means protecting consumers against food coming from some technologies still insufficient scientific arguments regarding the long-term effects - using plant growth hormones, genetically modified organisms.

Often consumers do not take into consideration safety criterion among the main criteria, because they are convinced that this is self-respect by the bidder and guaranteed by the legislation in force (Vrânceanu, 2007:29). Regarding the safety of products, there are differences in the degree of international acceptance through the legislation of the same product. (Vrânceanu, 2007:30).

In Romania in order to support the producers of bakery industry and to increase their competitiveness on national and international level, Employers Organization - Milling, Bakery and Flour Products - ROMPAN developed a guide to good hygiene practices, containing measures that ensure that each step in the theological process is in accordance with the standards of hygiene and food safety.

We consider that production of bread and bakery specialties is one of the most important areas of the Romanian food industry and therefore should benefit from such a best practice guide in order to assist producers for raising the quality and assurance food safety, leading to increased competitiveness of Romanian products. In Romania there are about 5.500 processors in the bakery and flour products, and about 3.300 in the milling sector (Catoiu, et al., 2010:4). The main agri-food enterprises from bakery sector are represented by Boromir, Vel Pitar, Titan, Dobrogea Grup and Pambac Bacau.

Ensuring products by certifications and identifying environmental aspects involved in, supports creating awareness for the product and for the food company.

For example „Topolveni Jam” is a protected geographical indication product (IGP) registered quality mark by European Commission, and “Pleşcoi sausage” is being recognized. These products have specific characteristics from areas of origin. Unfortunately in the agri-food Romanian market there are very few protected products compared to other European country. Italian agri-food market has around 1500 protected products.

Another agri-food enterprise is the Milk Factory Sevis of Sibiu Surroundings, a place full of tradition and full of meanings. Taking into account that SEVIS milk factory produces through art equipment, full range of dairy products, and recipes after the milk is processed are influenced by local tradition these products could be recorded as protected geographical indication.

Product certification, that targets primarily continuous product improvement, and transparency in the flow of production, has the advantages of allowing identification of weaknesses. In addition, it is possible to analyze the product characteristics, in particular those related to safety, health and environment at all stages of the life cycle, from conception to completion of the product life cycle. Finally, product certification optimizes the quality/ price rapport and provides customers with the confidence that certified products meet quality requirements. In our opinion the quality is warranted to be proven through product certification, especially if the agri-food companies perform a limited range of products.

#### *Ethical decisions in pricing policy*

Pricing is probably one of the most difficult areas of marketing mix when it is analyzed from the ethical point of view. According to Kehoe (1985:71-72), ethically, price should be equal or

proportional to benefit which is taken by the consumers. An ethical problem arising in price policy is related to products priced too high, especially relative to their inferior quality. Mismatches in the cost-price-quality product offered to consumers raise to market prices of commodities "no coverage".

In accordance with *double entitlement principle* price increases should not be made arbitrarily or just to increase profits, but they must be based on product cost increases. (Vrânceanu, 2007:31). Consumers consider correct setting pricing based on cost, but the action of price increases due to increased demand (generated for example by social or natural events) is considered unethical by them. For example Coca-Cola Company trying to introduce machines for soft drinks that change the price along with changes in demand (due to schedule or temperature) was strongly challenged.

The pricing decisions should take into account how consumers perceive price fairness. Perception of fairness (justice) price is governed by the belief that companies are entitled to obtain a reasonable profit, and consumers are entitled to pay a fair price.

Some pricing practices - in their essence unethical - are accepted without problems by the general public. An example is the use of psychological pricing, a common strategy used on market food products. This strategy consists in determining the price of a product with figures that end, by commas in 9, because the consumer will think the product cost less, that difference is actually negligible. (Darmon, 2006:221).

Discriminatory prices are the prices that target the same product, but differ in the level of certain categories of consumers. They can occur when a producer can favor one client, with more favorable prices, which reduces the accuracy of competitive relationships in which they engage in the consumer market. If unbundling an agri-food company must communicate openly all parties the qualifications and restrictions that generate an advantage in price. Sale price maintenance can also be an unfair practice if it is imposed on retailers by agri-food companies. But it is legal the recommendation prices for a certain period, retailers that provide these prices received some discounts from the producer.

Given that most agri-food are sold through hypermarkets chain is almost impossible for consumers to identify which is the real price of products purchased, due to additions that occur throughout the supply chain. Regarding price policy, a good practice from agri-food companies is to write on the product's label the recommended price and then leave it up to the consumer's discretion if he wants or not to buy, in the case the price on the shelf excessively exceed the recommended price.

#### *Ethical decisions in distribution policy*

In Romania conflict between retailers, producers and processors was launched in early March 2008, when employers and unions in the food industry accused large retailers of abuse of power on the domestic producers by imposing excessive contractual conditions (e.g slotting allowance), resulting in an extremely low profitability rate for them. These unfair practices are carried out especially by traders, and therefore we would not detail these because the purpose of our paper is to capture suppliers' (food processors') unethical behaviour. However we want to mention that in Romania authorities in an attempt to fix conflict situations between suppliers and retailers have adopted a code of good practice in agri-food industry, whose implementation should decrease the price of food products. Code of practice has been signed by The Romanian Food Industry Federation – ROMALIMENTA, The Romanian Meat Association – ARC, The Association of Dairy Processors – APRIL, Employers Organization - Milling, Bakery and Flour Products – ROMPAN, National Association of Flour Milling and Baking Industries – ANAMOB, National Union of Poultry Breeders, and traders as Metro Cash&Carry, Real-Hypermarket, Romania Hipermarche, Selgros, Carrefour, MGV Distri Hiper, Kaufland.

In reality, the Code did not take into account two important aspects: accurate definition of the purchase price and forbidden the sale of products under this price. If these two things were considered this code of good practice could change something in the food market and even to decrease prices of food products. (<http://www.recolta.eu>). According to the code of good practice

the suppliers (in our case an agri-food processor) are not allowed to condition the trader to retain a certain price on the point of sale (<http://www.euractiv.ro>), being considered an unfair practice.

Another area bring into attention regarding ethical decisions in distribution policy is the unauthorized use of marketing channels, also called "gray market" practice, that it can occur both within individual countries, but also abroad (parallel imports). (Vranceanu, 2007:36). Such action leads to emergence of price differences, unauthorized channel could practice lower prices. Also warranty granted by the producer cannot be applied for unauthorized channels, which is a source of dissatisfaction for consumers. Even if these gray markets can benefit consumers through lower prices, they are considered unethical practices because it does not offer after-sales services and guarantees for what is against it.

#### *Ethical decisions in promotion policy*

The most common problem of ethics faced by an organization is to create promotional message. A number of critics (Darmon, 2006) consider advertising as manipulative, informing consumers about the existence of products and services determining them to buy things they do not really want. Criticisms of promotional activities are related to higher selling prices compared to the costs of production and distribution, due to the fact that these prices have to finance the high costs of advertising and sales promotion.

There are situations when the message on the content of a product contains almost entirely untrue statements. For example a company in the beverage industry submits a carbonated soft drink that is natural, while in reality only part of the contents of this is natural (up to 15-20%). It is unethical that advertisements exploit the lack of knowledge or experience of the consumer.

Advertising to children is consider to make the subject ethical assess, as children are considered vulnerable. Some products can be harmful if are consumed inappropriately by children. For example a company in the production of sweets should not be overly involved advertising sweets because can generate consumer behaviors that are not in accordance with a healthy diet.

If we talk about the ethical character, using tricks when filming an advertisement is also viewed with reservations. These tricks are allowed to be used when proper recording of the spot may be affected by existing conditions at shooting. Thus, in a spot that promotes a brand of ice cream is allowed to use other compositions (e.g mashed potatoes) because ice cream would melt due to the heat generated by the camera. (Vranceanu, 2007:34).

### **3.4. Community and environment**

Viewed from a global perspective, food is not currently produced in the places or ways that best conserve natural resources. For example influence of packaging on the environment has led to increased concerns for the use of environmentally sound packs. Some agri-food companies try through such a concern to gain a competitive advantage by creating an image of environmental friendly, both the products offered, as well as the technological processes used.

Agri-food companies should use standards and codes as tools to promote sustainable development through their supply chains by influencing suppliers and other business partners to adopt more environmentally and socially responsible practices. All standards consist of a series of criteria, or rules, with which third-party suppliers are asked to comply. Enterprises should take eco-friendly and socially responsible decisions not only to help differentiate their own products but also to turn them into socially-conscious products. As a result of the internalization of social and environmental factors in the decision-making process, managers have developed the conviction that competitiveness is no longer a question of cost reduction but, rather, a promotion of distinctive factors. Social and environmental aspects are therefore key components of a competitive strategy which revolves not only in the distinctive qualities of goods but also in the distinctive features of the processes and the distinctive ethical values of the enterprise. (Marotta & Nazzaro, 2012:674).

Studies show that most agri-food companies have not defined an appropriate strategy to protect local communities and the environment. We consider that one way to determine food companies to improve their policies in this regard would be pressure from the public.

#### 4. CONCLUSIONS

The world today is changing rapidly. What is taken to be true today may be found to be false tomorrow. What is considered ethical today may be considered unethical tomorrow. Thus, no definitive blueprint for ethical behaviour and action is possible. What is necessary is that ethical positions be reviewed regularly to see how they might be improved on the basis of new evidence, new requirements and new demands.

The food supply chain connects important and diverse sectors of the Romanian economy that are essential for economic, social and environmental welfare as well as for the health of citizens.

One of the most unethical behaviour form the point of view of agri-food companies (e.g milk processing) is to force the producers to sell milk in high prices and if they do not accept, decide to import this product from other countries in lower prices. As a result cows' farms have closed and other has poor performances, because the lack of cooling tanks (to store large amounts) makes them to accept any cost imposed by processors. In our opinion agricultural producer is the one who make the greatest effort to achieve raw materials and agricultural products and in the end the share price paid to producer from the final consumer price is very low (about 30%). According to CIAA (2010) a single retailer often accounts for more than 60 percent of the business of a supplier while conversely, their business is of marginal importance to the retailer.

We can conclude that in almost all the activities of agri-food companies, the consequences of unethical behavior and decisions often affect consumer, especially in terms of product policy. In terms of pricing, distribution and promotion policies, unfair and unethical practices on consumers can not be directly controlled by management of agri-food enterprises, because of the intervention of other actors in the food supply chain. One solution for consumers is to be more informed and educated regarding the importance of integrating ethics issues in business conducted by agri-food companies.

This acknowledges the fact that attributes such as environmentally sound activities or "without child labor" must be communicated throughout the entire agri-food supply chain in order to be able to convey respective information to consumers and other stakeholders in a reliable way.

Given the above, we must be aware that the ethical or unethical activities held by the management of agri-food companies and how they understand social responsibility can have a positive respective a negative impact on consumers, business partners, communities and environment.

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