

## The Effect of Ethical Management on Organizational Performance

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### ABSTRACT

The main purpose of this study is to examine the effect of ethical management on job performance. For the study, CEO's will, ethical management system and external ethical activity are selected as subordinate variables of ethical management. Therefore, the concrete purpose of this study are four issues: (1) to examine the effects of CEO's will on organizational trust, (2) to examine the effect of ethical management system on organizational trust, (3) to examine the effects of external ethical activity on organizational trust, (4) to examine the effects of organizational trust on organizational performance. The sample for this empirical study is collected from 334 employees of 5 different companies executing ethical management. The results of analysis are as follows. First, there is a positive effect of CEO's will on organizational trust. Second, there is no effect of ethical management system on organizational trust. Third, there is a positive effect of external ethical activity on organizational trust. Last, there is a positive effect of organizational trust on organizational performance. Based on the results of this study, we suggested implications for business strategies and effective alternatives for ethical management.

**Keywords** : Ethical Management, CEO's Will, Ethical Management System, External Ethical Activity, Organizational Trust, Organizational Performance

### 1. INTRODUCTION

The era of ethics is advancing. Nowadays, the ethical management is not selective but essential factor to many corporations. Not only individual but also corporation, business ethics became very important theme. Moreover the business ethics is considered the source of corporation's competitive advantage.

Business Ethics showed trend to global standardization leading by OECD, EOA etc. and started to adopt 'OECD Convention on Combating Bribery of Foreign Public Official in International Business Transaction' by OECD in 1997. Owing to this trend, ethical management is becoming effective managerial mode of corporation and business in these days.

But some people misunderstand that ethical management is only effective means controlling employees and fashionable innovation instrument of management which has passed quickly. But true meaning of ethical management includes social, legal and ethical responsibilities which are anticipated social common idea. Recently, it seems that many corporations grasp fully this situation.

Ethical management contribute to obtaining trust from consumer and market and effect on real business performance. The real performance of ethical management is becoming big

concern to many corporations which are executing ethical management.

By the survey of FKL in 2006, among the 500 enterprises in Korea, 84.1% of them adopted business ethical management and 96.9% perceived as contributed to strengthen the power of corporate competition. This reveals that the Korean corporations consider ethical management as effective alternatives of business strategy level[1].

In this spreading trend, until nowadays some corporations doubt about ethical management's effectiveness and influence to real business performance. It means that ethical management itself is very abstract and the viewpoint of corporation for the ethical management is the problem to be tested empirically. Nevertheless, empirical study on ethical management is scarce in Korean academic world.

Noticing these problems, this study try to analyze empirically, how to affect ethical management on organizational performance. For this study, we selected ethical management as independent(exogenous) variable, organizational trust as mediating(exogenous and endogenous) variable, and organizational performance as dependent (endogenous) variable. And we chose subordinate variables of ethical management which are CEO's will, ethical management system, external ethical activity.

Therefore, the main purpose of this study is as follows. First, how CEO's will of ethical management effect on organizational trust, second, how ethical management system effect on organizational trust, third, how external ethical activity effect on organizational trust and last, how

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organizational trust effect on organizational performance. We empirically studied above theme and on the basis of this study results, we proposed the effective alternatives of ethical management and strategic implications of management.

## 2. LITERATURE REVIEW

### 2.1 Ethical management

Ethical management means the strategy that guarantee to competitive advantage by ethical main values of corporation and each employee. As we know above mention, the principal characteristic of ethical management is strategic dimension's managing method and business innovation skill that the social values of ethics reflects to situation of corporation's core competence derived from business ethics.

The reason of the increase for ethical management necessity is caused from changing environment around enterprises. That internal and external environment changes are necessary to ethical management for lessening the fatal business risk, obtaining the trust of stakeholder, completing of corporate social responsibility, global standardization of business ethics.

In preceding study, the influencing factor to ethical management is suggested diversely. Baunhart(1968) suggested that the influencing factors to ethical management behavior of supervisor, formal policy of enterprise, social ethics climate, behavior of coworker, monetary needs of individual[2]. Also Scott and Davis(1990) suggested in their study that influencing factors are behavior of supervisor and coworker, corporate ethics climate, official policy of corporation, monetary needs of individual[3]. Through these preceding studies we know that internal and external factors affect simultaneously on ethical management.

In the meanwhile, the argument has been existing about whether the ethical management is linked to business profit. This argument includes the problem about whichever perspective is right. Win-win relation or trade-off one? Until now two perspectives have been co-existing. But in recent year, many empirical studies show positive relations between ethical management and business profit[1].

In this study, we established subordinate variables of ethical management as CEO's will, ethical management system, external ethical activity for heightening organizational performance in order to conduct empirical study.

#### 2.1.1 CEO's will

CEO's will mean belief and practical intention about necessity of ethical management. And it means CEO will be a good model and active encouragement to employee. By means of decision making of strategic viewpoint, CEO induce employee to fit the ethical management's goal and strong influence to practice for employees. In many preceding study, it is considered that CEO's will is the critical factor of successful ethical management.

According to Lee et al.(2006), listing company's CEO response to CEO's ethical values of ethical management which construct ethical management base affects positively to performance[4]. And in real ethical management survey by FKI

in 2001, 76.3% enterprises respond that CEO's will is the critical factor in practice of ethical management. This shows that the practice and perception of CEO is the key factor of proliferation for ethical management within corporation[5].

By the empirical study of 323 employees in 8 corporations, Choi et al.(2005) suggested CEO's will of ethical management practice has positive relation with other ethical management factors including whole successful ethical management and organizational commitment[6].

In this study, operational definition of CEO's will is 'a belief and propelling volition of ethical management of CEO.' And CEO's will be measured by CEO's belief about ethical management, perception role, observation of ethics standard, and support to relate department. These 4 measurement questions were adopted from the questionnaire of Choi et al.(2005) and measured by Rikert-type 5 point scale[6].

#### 2.1.2 Ethical management system

Ethical management system as a process and system of corporation means enactment of ethics code, appointment of chief ethical officer(CEO), establishment of ethical management department, ethics education and ethics evaluation by company.

In the same context, Mizda(Japan Business Ethics Association) insists that ethical management system consist of '3C'(i.e., namely, alone ethics code for business ethics observance, full charge executive and department, internal prosecution system, ethics evaluation system, and consensus by ethics education inside company)[7].

The reason why the ethical management system important is ethical management achieve when the ethical management propel to organization level in long and continuous viewpoint.

According to research by Lee(2007) from 200 employees and consumers in domestic, the ethical management implementation affects positively on brand value[8]. Also Oh(2004) suggested in her study that ethical management system affects positively on corporate social responsibility (CSR) including external society and customer[9].

In this research, operational definition of ethical management system is 'a process and system intend to specify ethical management of corporation' and measured by enactment of standard business ethics, inclusion of employee must observe code of ethics, appointment of responsible person and department executing ethical management. These 4 measurement questions were adopted from questionnaire of Choi et al.(2005) and measured by Rikert-type 5 point scale[6].

#### 2.1.3 External ethical activity

External ethical activity include publicity of ethical management policy, business ethics standard to external stakeholder, donation of corporation's part profit for local society and nation. In the end, this ethical activity is active operation of corporation much over the responsible limits of corporate burdening.

A study by Choi et al.(2005) suggested that external ethical activity including induction of stakeholder's participation effect positively on organizational commitment which is important to attitude of employee in organization[6].

In this paper, operational definition of external ethical activity is ‘an activity and endeavor to let know for all stakeholders about ethical management policy and business ethics standard of corporation.’ And this external ethical activity measured by public relation of ethical policy, ethics observance in transaction with business partner, explanation about ethics policy and support inducement, donation of corporation’s profit for society. These 4 measurement questions were adopted from questionnaire of Choi et al.(2005) and measured by Rikert-type 5 point scale[6].

**2.2 Organizational trust**

Trust is multi-dimensional concept. Basically trust form among the person connected to social exchange relation and means belief to supervisor and organization. Because of education and training of ethical management are performing organizational level, it is important in ethical management that organizational trust related to the whole enterprise. After all organizational trust of employee became a foundation of enterprise ethical management.

According to the study from 296 employees in domestic by Choi(2007), CEO’s will and external ethical activity effect positively on organizational trust. Also organizational trust effect positively on organizational citizenship behavior subordinate variables(altruism, courtesy, civic virtue)[10]. And in their study, Park et al.(2005) suggested that organizational trust moderate among ethical management and job satisfaction, reward satisfaction, organizational citizenship behavior[11].

Also a study by Choi(2007) suggested organizational trust mediate between ethical management and organizational performance. Concretely, organizational trust mediate between CEO’s will and civic virtue, CEO’s will and altruism, external ethical activity and civic virtue, operation of ethics code and courtesy, operation of ethics code and civic virtue, activity of ethics education and courtesy, activity of ethics education and civic virtue[9]. Besides, Lee et al.(2008) suggested that customer and social responsibility effect positively on organizational trust[12] and Kim(2008) suggested that justice perception of employee in Contingent Workers effect positively on organizational trust[13].

In this research, operational definition of organizational trust is ‘a belief of employee to be helpful and favorite to employee to organization.’ And organizational trust measured by corporate honesty, promise observance, reward trust, trust for vision. These 4 measurement questions were adopted from questionnaire of Cufaude(1999) and measured by Rikert-type 5 point scale[14].

**2.3 Organizational performance**

Organizational performance has multiple dimensions too. Though traditional view started financial standpoint, recent view has developed variously. For example, BSC(balanced scorecard) considered simultaneously customer, internal business process, learning and growth and financial standpoint.

Performance of ethical management can be classied into individual, organizational, social performance. But important point is ethical management connected to organizational

performances which intend to embody ethical management within managerial process of corporation. And it is necessary that these features should be emphasized to employee and induced to commitment of employee.

According to the study by FKI(2001), ‘the relation analysis business ethics, corporate value and performance’ from 30 companies subject to combinat in domestic suggested that ethical management had connected to organizational performance. Therefore, the corporation’s stock price rising ratio and sales amount operating interest rate of ethical management executing corporation are better than don’t corporations[15].

In this study, operational definition of organizational performance is ‘a performance consist of financial and non-financial result that employee perceived.’ According to above operational definition, organizational performance measured by customer satisfaction, product quality, service quality and market share. These 4 measurement questions were adopted from questionnaire of Delaney & Huselid(1996) and measured by Rikert-type 5 point scale[16].

**3. METHODOLOGY**

**3.1 Definition and Construct Measurement**

All definitions and construct measurements in this study are as follows(Table 1, Table 2).

Table 1. Definition of Construct

Construct	Operational Definition
CEO’s Will	A belief and propelling volition of ethical management of CEO
Ethical Management System	A process and system intend to specify ethical management of corporation
External Ethical Activity	An activity and endeavor to let know for all stakeholders about ethical management policy and business ethics standard of corporation
Organizational Trust	A belief of employee to be helpful and favorite to employee to organization
Organizational Performance	A performance consist of financial and non-financial result that employee perceived

Table 2. Construct Measurement

Construct	Variable	Supporting Literature
CEO’s Will	CEO holds strong belief and willingness about practice of ethical management and emphasizes to practice them.	Choi et al. (2005)[6]
	CEO know his/her role and responsibility for practice of ethical management.	
	CEO shows good models to his employees keeping rules and ethical norms.	
	CEO supports ethical management teams actively.	
Ethical Management System	My company has established the code of ethics, the guideline of ethics, the manual of the code of ethics and has operated them very well.	Choi et al. (2005)[6]
	We can find the ethics to keep for employees of my company in the code of ethics.	
	There is someone who is responsible for the ethical management in my company and he/she supports it.	
	We have specific parts to expel ethical management.	

External Ethical Activity	My company advertises the ethical management system to the public for the customers to know about the system and the ethical norms.	Choi et al. (2005)[6]
	My company practice ethical management system in selecting provider, screening, and holiday season.	
	My company tries to explain and draw support from stockholders and investors about the ethical management policy and direction in various ways.	
	My company spends part of company interests for the nation and community and does its clear and honest business activities.	
Organizational Trust	My company tells me everything without secret.	Cufaude (1999)[14]
	My company keeps promise well.	
	If I perform my duty, my company supports and rewards me.	
	I have confidence in vision and objectives of my company.	
Organizational Performance	I believe that my company holds higher customer satisfaction than rivals.	Delaney & Huselid (1996)[16]
	I believe that my company holds higher product quality than rivals.	
	I believe that my company holds higher service quality than rivals.	
	I believe that my company hold higher productivity of employees than rivals.	
	I believe that my company holds higher market share than rivals.	

**H2: Ethical management system will produce a positive effect on organizational trust.**

In previous study, Choi et al.(2005) suggested that ethical management system as a process and corporate system affects positively to corporate social responsibility. Therefore, I established the hypothesis 3.

**H3: External ethical activity will produce a positive effect on organizational trust.**

In their previous study, Lee et al.(2008), Kim(2008), Choi(2007) and Park et al.(2005) suggested that organizational trust relates to organizational performance. And FKI(2001) suggested that ethical management connected to organizational performance. Therefore, I established the hypothesis 4.

**H4: Organizational trust will produce a positive effect on organizational performance.**

**3.3 Sample and Data Analysis**

Sample of this research consists of 334 employees of 5 firms in Korea. And main sample characteristics are as followings.

Gender is composed of 238male(71.3%) and 96 female (28.7%), average age is 36.8 years old, scholarly is high school 38(11.4%), college 21(6.3%), university 232(69.5%), graduate school 41(12.3%). Average job tenure is 8.7 year, marital status is married 235(70.4%), not married 98 (29.3%), job classification is a member 122(36.5%), assistant manager 73(21.9%), manager 62(18.6%), assistant director 55(16.5%), director of department 10(3.0%), type of industry is manufacture 33(9.9%), finance 147(44.0%), service 27(8.1%), electronics 54(16.2%), public firm 69 (20.7%).

Through SPSS 12.0 program, the frequency test about sample characteristics was conducted. And then by the AMOS 16.0 program, confirmatory factor analysis and structural equation model analysis for hypothesis test were carried out.

**4. RESULTS**

**4.1 Measurement Model**

Anderson and Gerbing(1988) insist that structural equation model(SEM) use two-step approach. It consist of confirmatory factor analysis(CFA) and SEM analysis to test for hypothesis[17].

In CFA step, we analyzed reliability and validity of collected data. CFA results in this study suggested in Table 1. According to Fornell & Larcker(1981), in case of construct reliability(CR) over 0.7 and average variance extracted(AVE) over 0.5 which achieved a favorite level. Therefore, reliability and convergent validity of measurement model of this study are guaranteed[18]. In Table 1the statistics of measurement model offered should be accepted because most of model fit indices are showed standard statistics( $\chi^2=354.86$ ,  $p=0.000$ ,  $df=160$ ,  $GFI=0.904$ ,  $AGFI= 0.874$ ,  $NFI=0.930$ ,  $CFI=0.960$ ,  $RMR=0.029$ ).

**3.2 Research Model and Hypothesis**

On the basis of literature review, we could found each variables(CEO's will, ethical management system, external ethical activity, organizational trust, organizational performance) relationship, so we found this research model and hypothesis.

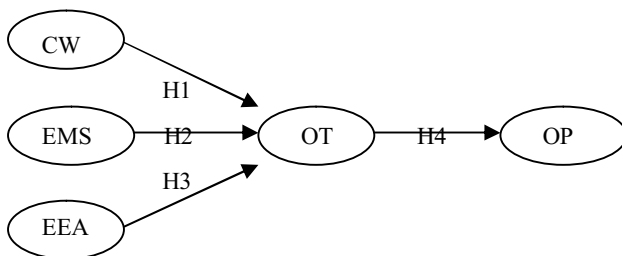


Fig. 1. Research Model

In fig. 1, CW means CEO's will, EMS means ethical management system, EEA means external ethical activity, OT means organizational trust and OP means organizational performance.

In pervious study, Lee et al.(2006), Choi et al.(2005), and FKI(2001) suggested that CEO's will in ethical management affects positively to organizational trust and CEO's will is the key factor in practice of ethical management. Therefore, I established the hypothesis 1.

**H1: CEO's will will produce a positive effect on organizational trust.**

In their study, Lee(2007) and Oh;2004) suggested that ethical management system affects positively to brand value and corporate social responsibility. Therefore, I established the hypothesis 2.

Table 3. Results of Factor Analysis

Construct	Variable	Estimate	S.E.	t	Construct Reliability	Variance Extracted
CEO's Will	CW 1	0.865	0.016	1.000	0.994	0.9776
	CW 2	0.885	0.013	21.643		
	CW 3	0.842	0.016	19.830		
	CW 4	0.800	0.021	18.160		
Ethical Management System	EMS 1	0.847	0.017	19.744	0.993	0.973
	EMS 2	0.833	0.016	19.189		
	EMS 3	0.862	0.018	1.000		
	EMS 4	0.777	0.023	17.159		
External Ethical Activity	EEA 1	0.747	0.030	15.626	0.991	0.967
	EEA 2	0.851	0.018	1.000		
	EEA 3	0.815	0.019	17.754		
	EEA 4	0.800	0.019	17.256		
Organizational Trust	OT 1	0.794	0.027	1.000	0.990	0.963
	OT 2	0.820	0.024	15.927		
	OT 3	0.794	0.024	15.341		
	OT 4	0.798	0.023	15.419		
Organizational Performance	OP 1	0.855	0.024	1.000	0.990	0.962
	OP 2	0.822	0.025	18.026		
	OP 3	0.839	0.022	18.574		
	OP 4	0.769	0.035	16.329		

$\chi^2=354.86(p=0.000)$ ,  $df=160$ ,  $GFI=0.904$ ,  $AGFI=0.874$ ,  $NFI=0.930$ ,  $CFI=0.960$ ,  $RMR=0.029$

Correlation matrix and variance extracted are shown Table 2. In Table 2, as a result of correlation analysis among each construct correlation analysis, we suggest that discriminant validity is satisfied. Because the squared multiple correlation (SMC) is lower than the variance extracted and diagonal line matrix 'I'[19].

Table 4. Correlation Matrix and Variance Extracted

Construct	1	2	3	4	5
CEO's Will	0.9776*				
Ethics Management System	0.749	0.973*			
External Ethical Activity	0.673	0.724	0.967*		
Organizational Trust	0.334	0.684	0.713	0.963*	
Organizational Performance	0.358	0.667	0.586	0.683	0.962*
Mean	4.2597	4.2672	4.1403	3.7646	3.9281
Std. Deviation	0.68998	0.69363	0.68087	0.70778	0.77649

\* Diagonal line matrix of each construct means variance extracted.

\* Correlation coefficients are significant at  $\alpha=0.05$  level.

## 4.2 Hypothesis Testing

Hypothesis testing of this research by path model results are summarized in table 3. To test the causality of research model about ethical management, we analyzed the causality through path analysis. By the analysis, all fit indices of this research model are acceptable level( $\chi^2=36.8$ ,  $p=0.000$ ,  $df=3$ ,  $GFI=0.960$ ,  $AGFI=0.799$ ,  $RMR=0.042$ ,  $NFI=0.958$ ,  $CFI=0.961$ ).

Table 5. Hypothesis Testing Results

Paths	Direction	Estimate	S.E.	t	Results
H1 CW→ OT	Positive	0.291	0.072	4.123***	Support
H2 EMS→ OT	Negative	0.025	0.077	0.332	No Support
H3 EEA→ OT	Positive	0.319	0.070	4.718***	Support

H4 OT→ OP	Positive	0.598	0.048	13.62***	Support
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p value : \*\*\*<0.001

As clearly indicated in table 3, one hypothesis(H2) of them was no support but the other three hypotheses were support. These results mean that ethical management excluding ethical management effect on organizational trust. Especially, support H1 is correspondent with preceding study[4]. No support of H2 means that ethical management system itself does not effect on organizational trust. That is, process and system of corporation is not critical factor of rising organizational trust. And organizational trust effected on organizational performance.

## 5. CONCLUSION

### 5.1 Summary and Implications

The summary of this study and their theoretical, managerial implication are as followings.

First, CEO's will effect positively on organizational trust. This result implicates that the strong belief of CEO can heighten corporate trust through employee's practice of ethical management. And on the basis of CEO's transition of perception, CEO must support strongly to employee executing ethical management and believe strongly for himself or herself. Also, CEO must maintain firm conviction about practice of ethical management and emphasizes to practice their employees. And CEO must present good models to his employees observing ethical norms.

Second, we confirmed that ethical management system did not effect significantly on organizational trust. This result implicates that though ethical management system is necessary to practice of ethical management, ethical management system itself did not heighten the corporate trust. So, we could know that the specific and practical operation of ethical management system is very important to success in effective ethical management. So the company must operate ethical management systems effectively as well as establish them.

Third, we certificated that external ethical activity effect positively on organizational trust. It implicates that corporate social and customer responsibility heighten corporate image or trust. Therefore, active practice of ethical management and external public relation are necessary to ethical management executing company. The company must advertise the ethical management to the public for the customers to know about the system and the ethical norms. And the company must spend part of company interests for the country and local society.

Finally, we affirmed that organizational trust effect positively on organizational performance. It implicate that corporate trust heightened by ethical management is very important factor which affect corporate performance. In order to obtain the trust from employees, the company must tell employees truth without secret.

## 5.2 Suggestions

This research opens the door for at least three future study streams between ethical management and organizational performance.

First, this study limited 4 subordinate variables within CEO's will, ethical management system, external ethical activity, but if use various variables in future research, we can obtain more meaningful results about ethical management.

Second, in further research, subdivided study of ethical management performance is needed. Because performance of ethical management is diverse, if we reflecting these characteristics in further study, it is helpful to understanding of whole effectiveness on ethical management.

Third, this study is cross-sectional study conducted special point of time but longitudinal study is needed methodologically. Because of, in many case, ethical management performance comes from long labor of corporations.

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