

## **Ethical Work Climate and Firm Performance**

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### **Abstract**

*This study aimed to investigate the relationship between Ethical Work Climate (EWC) and Firm Performance. The research conducted within Malaysian manufacturing companies. Since the unit of analysis was organization, 200 cases were selected randomly. The result of pilot test confirmed that all instruments are reliable to be used. Data was collected using a self-administered questionnaire. Managers as target respondent explained their perception via standardized questionnaires. Previous studies show that there is not enough documented research on such topics in Malaysia. So, it may open a new phase and develop the body of knowledge in this area. Based on the results, the study found a high correlation and significant relationship between EWC and Organizational Performance (OP) in Malaysian firms. It means the perception of managers regarding the ethical manners and ethical climate is positive.*

**Key words:** Ethics, Organizational performance, Firms

### **1. Introduction**

The Malaysian Small and Medium Enterprises (SMEs) can be expected to contribute towards the nation's financial performance. The large numbers of SMEs provides employment opportunities and acts as catalyst in areas such as manufacturing, financing, business and facilities. SMEs also can be strengthened as the engine of growth. Their continued existence in the market depends on their productivity and financial performance.

They also helpful for develop the technical, managerial, and business skills (Aris, 2007). As such it is important for SMEs to practice good ethics in its business dealings. Past studies have shown that there is a link between corporate ethical practices and performance. However, the studies have been inconsistent in determining whether the link is either positive (McKendall, DeMarr, & Jones, Ridders, 2002) or negative (Baucus and Near 1991; Weaver, Trevino, 1999).

This study tries to find the relationship between ethical work climate and firm performance among electrical and electronic SMEs. The study will be conducted in four zones within Malaysia by using primary data. A total of 200 SMEs will be selected randomly. Since the high performance considered as a main target in each organization, so that the significance of study goes to importance of strategies and plans. These strategies can provide the basis for Malaysian industry in future. Hence the SMEs will be able to develop the organizational trust training programs.

## **2. Research Background**

The previous studies indicate that although managers in Malaysian SMEs are interested to observe good business practices, sometimes the realities forced them to make compromises. The managers often feel constrained and have to make unethical adjustments for a variety of reasons, such as stiff competition, organizational ethical climate (OEC), and ethical behavior. In addition the lack of effective guiding mechanism in facing complex ethical problems has become another important point (Gupta & Sulaiman, 1996).

study in four small sized municipal governments conducted by Daly (2002), shows there is strong relationship between positive organizational climate and successful process; but this research revealed that there is less evidence to support the impact of ethical leadership on organizational performance (Daly, 2002). A World Bank survey of manufacturing indicates that Malaysian firms are doing less to develop innovative processes than those of similar countries. Survey conducted in 2000 and 2007 indicates that Malaysian firms prefer to undertake less sophisticated activities, such as upgrading existing product lines or machinery (New Economic Model for Malaysia Part1, 2011).

Only the third of excellent companies remain excellent over the long time (Keller & Price, 2011). Organizations in both nonprofit and public sectors need to look for continuously improvement and to sustain high performance. As a new developed country, Malaysia has seen its share of corporate irregularities, and accusations of violation or infringement of EWC. Thus those factors that influence the organizations' performance in such cases would be useful, but the dearth and the lake of studies from a Malaysian context does not help to take a deep place (Miller, 2008). Burns and Brady (1996); Pettijohn, Pettijohn, & Taylor, (2008) concluded that in developing countries like Malaysia, it is expected the country have lower ethical perception rather than their counterparts in developed nations. Miller (2008) in his study indicates that there may be a fundamental shift away from such idea.

Furthermore, Shigematsu, Mizoue, Kajisa & Yoshida (2011) claimed that Malaysia does not hold integrity as an important issue; whereas Tan & Sim (2011) concluded that supplier measures-strategically, customer relationship, and information sharing improve the organizational performance. In another study, Abdul and Ibrahim (2002); Rashid and Ibrahim (2008) found that from Malaysian managers point of view the business activities are more ethical today rather than they were 30 years ago. Another study in Malaysian companies shows a positive relation between Ethical leadership and firm performance (Khademfar & Arabamiry, 2013). As a result recently a positive picture has been presented regarding the ethical perceptions of Malaysian managers. Therefore it represents a noticeable shift in perception towards more positive levels of ethical behavior. However this may reveal the higher levels of awareness of the importance of ethics (Miller, 2008).

## **3. Objectives**

The Main objective of study was to determine the relationship between Ethical Work Climate and Firm performance within SME organization. In addition the research has determined the relationship between Self interest, Organizational Interest, Team Interest, Stakeholder Orientation, Personal Morality, Rules, Law and Professional Codes, Friendship, Efficiency, as predictors of independent variable and Organizational Performance; these factors have been measured separately by some respective items.

## **4. Research Methodology**

### **4.1 Population and Sample Design**

According to official updated website of SME corporation, the total number of active established electrical and electronic company is 545 (SME CORP, 2013). The majority of these companies located in Johor 11.74 Percent, Selangor 42.2 percent, Pinang 15.78 percent, and Kuala Lumpur, 11.93 percent (Table 4.1). The researcher chose these four main regions, which contain 81.65 percent of total companies (Table 4.2). Some scholars believe that in order to gain a desired level of statistical power of a complex model, the minimum sample size (100) should be exceeded. As a rule of thumb, any number above 200 is understood (Ho, 2006; Hair et al., 2010).

Based above criteria and using Cochran formula the sample size for this study will reach to 200; the unit of analysis in this study is Organization. The respondents include top managers, senior managers, and middle managers. The researcher selected 200 cases after listing the name of all active SMEs by simple random sampling style. In order to provide equal and logical chance for every company, the researcher made accountable distribution for four major locations as below (Table 4.2).

### **4.2 Instrumentation Design**

The instruments in this study utilized as: a) Victor and Cullen's Ethical Climate Questionnaire (ECQ); b) Organizational Performance questionnaire. The questionnaires filled and completed by top managers, senior, or middle managers. Data collected using a self-administered questionnaire that distributed among 200 electrical and electronic companies.

### **4.3 The measurement of independent variable (EWC)**

The ECQ developed by Victor and Cullen (1987, 1988) assesses the Ethical Climate within the organization. Its construct is founded on the presumption that organizational climates can be sorted into dimensions analogous to Kohlberg's ethical standards (egoism, benevolence and principle) and ethical concern (individual, local, and cosmopolitan). Cross-classification of these factors which are reflected on the questionnaire resulted in nine theoretical ethical work climate dimensions (Vaicys, Barnett, & Brown, 1996). The questionnaire, initially consist of 26 items; later has been expanded to a 36-item version (Cullen, Victor & Bronson, 1993). This study applied the 36 items version.

Generally Its design accomplishes two tasks: one, to record the respondent's perception about how organizational members normally make decisions involving events, practices and procedures that require ethical criteria (Victor & Cullen, 1987); and two, to identify the firm's decision making norms. So every single question in the questionnaire contains a direct referent to one of the ethical reasoning criteria (Cullen & Victor, et al., 1993). The ECQ is designed to present respondents as observers, that report perceived organizational expectations and not as evaluators; it is not concerned with either the participant's ethical behavior or whether the perceived climate is good or bad. The focus is to delineate the climate types that exist and how the climate types influence the ethical conflicts (Victor & Cullen, 1987, 1988).

### **4.4 Validity and Reliability of ECQ**

Victor and Cullen have performed numerous validation analyses on their ECQ. With the exception of climate type Independence, in studies the value of Cronbach alpha exceeded to 0.70; which is considered good. The summary of results displayed in Table 4.3 and Table 4.4 (Cullen et al., 1993). The 1993 research by Cullen, Victor and Bronson indicated that Social Responsibility is a discrete climate; company profits remains the only undocumented psychological or individual climate type. In a later study that has been conducted by Vaicys, Barnett and Brown (1996) 1000 members of the American Marketing Association were selected.

Findings provided additional support for the multi-dimensionality of the ECQ. The researchers asserted that "Victor and Cullen's (1987, 1988) ECQ appears to be a useful tool that can be used to assess various dimensions of the perceived ethical climate within the organization" (Vaicys, Barnett, & Brown, 1996). In another study Maesschalck (2005), in his empirical research used the ethical climate questionnaire; the factors and deal of Cronbach Alpha showed as below (Table 4.5)

This investigation examines the perceived ethical climate that relates to firm performance. To achieve this goal, Victor and Cullen's 36-item survey used to determine the managers' perception. The style of climate will be determined by analyzing the mean Likert-type scale scores computed for individual responses based on the five commonly observed in ethical climate literature: Instrumental, Caring, Independence, Rule, Law and Code (Cullen, Victor & Bronson, 1993).

#### 4.5 The measurement of dependent variable (OP)

Performance has been conceptualized using financial and non-financial measures from both objective and perceptual sources. Objective measures include secondary sources, but financial measures are defined by return on assets, return on investment, and profit growth (Venkatraman, & Ramunujam, 1986). The new business environment and new sort activation is characterized by importance role of customer, employees, and finally society. Based on this belief, this study strived to find out and prepare the appropriate measurement in order to determine the OP in manufactures (Dimovski and Skerlavaj, 2005; Skerlavaj et al., 2007).

The factors which related to the study introduced as: Financial measures, Suppliers' measures, Employees' measures, and Customers' measures. Each factor has been measured by some items. The instrument consists of 19 measurement items. The respondent selected between two opposed statements on a five- point Likert scale while: 1= strongly disagree to 5= strongly agree (Dimovski, & Skerlavaj, 2005; Skerlavaj et al., 2007).

#### 4.6 Survey Translation Procedure

The original instruments in this study were in English language; in order to use in non-English context, the researcher asked professional translators to translate the items and instructions into Malay. The three translated copies of questionnaires judged by three experts who are familiar with both languages for more confident. The final draft translated to English again for comparing with original one. This process of back translation will assure the researcher about the accuracy and equivalence of translated version.

#### 4.7 Content validity

The content of instruments must be intended and interpreted in accordance with the purposes of study; therefore the collective nature content of the instruments in current research directly has contributed to the content validity. Moreover it is commonly practiced to assure content validity at two stages; the first one is experts' judges prior to embarking on the collecting data using the instrument, and the second one testing validity of the content at the pilot test. This study cared the validity of instruments through both of these practices.

#### 4.8 Four stages of instruments' confirmation

- **Pool;** first of all several questionnaires gathered and the most relevant has been chosen to apply for this study.
- **Focus group;** the researcher provided a group consist of some experienced people who are expert in this particular area. They were asked to read the questionnaire package and describe their ideas about the clarity, readability of items, and any redundancy within the instrument.
- **Pretest;** few cases of companies had been chosen to reply their understanding of questions through answer to provided instruments. The result of pre-test confirmed the face validity and showed that questions are relevant to their respective organizations.
- **Pilot test;** The result of pilot test will complete the instrumentation design procedure; in this stage the researcher will be confident about readability, clarity, redundancy, and validity by assessing the feedbacks. This step will test the research methodology and ensure the validity of instruments (Ary, Jacobs & Razavieh, 2002); the study provided a pilot survey; 30 electrical and electronic enterprises in Kuala Lumpur and Selangor selected to conduct the survey.

The reliability of instruments has been determined by measuring the Cronbach alpha. The value of Cronbach Alpha for all factors are above 0.70 which assumed the scale of measurement is reliable. Supplier Measurement as second indicator of OP, consist of one item, therefore it is not available. The result of Pilot-test illustrated in Table 4.6.

## 5. Result and discussion

The results of analysis show 91% of managers in Electrical and electronic SMEs are male and 9 % are female. The majority (80 %) are married. In addition the statistics reveal 56% of respondents have a bachelor degree and 25% of total managers have an associate degree; 6% have master degree and the rest(13%) are diploma or below. The results show the maximum tolerance of age is from 20 to 48; the most frequency is located between 28 to 33years old, which cover 42 % of respondents. 14% of managers have at least 10 years experience in their job and 46% of them have between 4 to 9 years experience. 11% of respondents in this study were top managers, 62 % dedicated as middle manager and 26 % of them were supervisor in their job position.

Based on the main objective, this study aimed to investigate and find the relationship between EWC and OP. The result of regression analysis (Table 5.1 and Table 5.2) reveals that the value of  $F=64.146$ ,  $t=8.009$ . Since  $Sig=0.000<0.05$ , therefore there is a significant relationship between EWC and OP at 0.05 level of significance. For more confident researcher has analyzed all EWC factors to find out the relation toward the organizational performance separately. As it shown in Table 5.3 all Sig value, "F" ratio, and "t" value prove the argument of significant relationship, unless one factor which called "Personal Morality".

Based on research methodology the DV in this study contain four dimensions; including Financial, Support, Employee, and Customer's measurement. Moreover the Ethical Climate Questionnaire (ECQ), consist of nine dimensions considered as IV. In continue the researcher applied a correlation statistic analysis via considering all independent and dependent factors. The value of coefficient "r" (Pearson) explains how every single factor of EWC correlate with Organizational Performance factors (Table 5.4). The result of Sig value in this particular analysis reveal that from total 36 correlation matrixes all factors related to each other except 7 cases. In general the proposed research questions could be answered positively.

## 5. Conclusion

Based on the results, the study found a high correlation and also significant relation between EWC and OP in Malaysian firms. It means the perception of managers regarding the ethical manners and ethical climate is positive. In the other word providing a suit work-place for employee will enhance and improve the organizational performance. It is important to review and upgrade the national plans based on new community's requirements. Furthermore allowing be survive and exist the productivity activities supposed to be a basic goal for industrial sector. In this case training programs for all employees especially for managers may reconsider for such companies.

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**Table 4.1 Distribution of electrical & electronic SME based on location**

Location	Number of company	Active company	percentage
Kedah	81	23	4.2
Kuala Lumpur	357	65	11.93
Kelantan	11	4	0.73
Johor	294	64	11.74
Melaka	65	16	3.7
Pahang	21	6	1.1
Perak	79	29	5.3
Perlis	1	0	.00
Pinang	274	86	15.78
Sabah	22	10	1.83
Sarawak	46	5	0.9
Selangor	614	230	42.2
Terengganu	22	7	1.28
Total Number	1887	545	100

Source: official website, SME CORP, Malaysia, Annual report, 2013

**Table 4.2; Location and distribution of selected cases for sample size**

Location	Number of active company	Selected cases for sample
Kuala Lumpur	65	29
Johor	64	29
Pinang	86	39
Selangor	230	103
Total	445	200

**Table 4.3: Ethical Climate Cronbach Alpha scale Reliability Scores**

Theoretical Type of climate	Administrative Science Quarterly (1988)	Corporate Social Performance and Policy (1987)
Caring	0.80	0.82
Law & Order	0.79	0.81
Rules	0.79	0.75
Instrumental	0.71	0.78
Independence	0.60	0.65

**Table 4.4: Ethical Climate Questionnaire Consistency**

Theoretical Type of climate	Alpha for 3 Studies
Caring (Friendship & Team Interest)	0.85
Law & Order	0.76
Rules	0.76
Instrumental	0.80
Independence	0.77
Efficiency	0.69
Social Responsibility	0.85

**Table 4.5: ethical climate Cronbach Alpha scale reliability**

Theoretical Type of climate	Cronbach Alpha
Self Interest	0. 869
Organizational interest	0. 610
Team interest	0. 771
Stakeholder Orientation	0. 778
Friendship	0. 797
Personal	0. 659
Efficiency	0. 787
Rules & laws	0. 837

Scores: Jeroen Maessehalck (2005)

**Table 4.6; Cronbach Alpha scale reliability of pilot test**

Variables	Cronbach Alpha	Variables	Cronbach Alpha
<b>Ethical Work Climate</b>		<b>Organizational Performance</b>	
1.self-interest	0.724	1.Financial Measurement	0.738
2.organizational interest	0.757	2.Supplier Measurement	N/A
3.team interest	0.786	3.Employee Measurement	0.918
4.stakeholder orientation	0.809	4.Customer Measurement	0.782
5.friendship	0.801		
6. Efficiency	0.851		
7.personal morality	0.740		
8.Rules	0.707		
9.Law& professional codes	0.698		

**Table 5.1; ANOVA<sup>a</sup>**

Model		Sum of Square	df	Mean Square	F	Sig.
1	Regression	4365.830	1	4365.830	64.146	.000 <sup>b</sup>
	Residual	13475.990	198	68.061		
	Total	17841.820	199			

a. Dependent Variable: Performance  
 b. Predictors: (Constant), EWC

**Table 5.2; Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.
1	(Constant)	33.260	5.737	Beta	5.798	.000
	EWC	.265	.033	.495	8.009	.000

a. Dependent Variable: Performance

**Table 5.3; result of “t” & “f” value**

<b>Factor</b>	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>	<b>t</b>	<b>Sig</b>	<b>F</b>
Self-interest	0.946	0.197	0.323	4.8	0.000	23.10
Org-interest	1.04	0.208	0.935	6.8	0.000	46.21
Efficiency	1.24	0.222	0.370	0.5.6	0.000	31.39
Friendship	1.55	0.213	0.460	7.28	0.000	53.01
Team interest	0.967	0.204	0.319	4.73	0.000	34.67
Stakeholder	1.47	0.250	0.386	5.88	0.000	34.67
Personal morality	0.109	0.117	0.066	0.933	0.352	0.871
Rules	0.658	0.232	0.198	2.84	0.005	8.07
Laws	1.77	0.236	0.422	7.53	0.000	56.76

**Table 5.4; the value of coefficient “r” (Pearson)**

<b>EWC/OP</b>	<b>Financial</b>	<b>Support</b>	<b>Employee</b>	<b>Customer</b>
Self-interest	0.000	0.753	0.000	0.001
Org-interest	0.000	0.000	0.000	0.000
Efficiency	0.001	0.005	0.000	0.002
Friendship	0.002	0.006	0.000	0.001
Team interest	0.137	0.020	0.000	0.010
Stakeholder	0.250	0.000	0.000	0.000
Personal Morality	0.785	0.036	0.188	0.706
Rules	0.456	0.022	0.004	0.009
Laws	0.004	0.022	0.000	0.000