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**Ethical Commitment, Corporate Financial Factors: A
Survey Study of Korean Companies**

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Abstract

To date, a variety of stakeholders including investors, corporate managers, customers, suppliers, employees, researchers, and government policy makers have been interested in the relationship between ethics and profits. In a same vein, during last decade business ethics and corporate valuation have received great attention in Korea. However, the link between corporation's financial performance and its commitment to business ethics has rarely investigated. Thus, this paper speculates the relation between corporate business ethics and corporate financial performance.

Key words: Business ethics, Ethical Commitment, Financial Performance, Korea, Valuation

JEL classification: M14, O57

1 Introduction

In an era of global business environment, the discussions of business ethics have been increased in various countries (e.g. Nakano (1999); Jackson *et al.* (2000); Sims and Geoez (2004)). Until the last decade, public had not exposed sufficiently to the importance of business ethics in Korea. Over the past decade, however, business ethics and corporate transparency have received increased attention in Korea. As a result, the concerns for business ethics have been able to permeate to public interests. Nevertheless, current corporate managers tend to believe that questionable unethical practices still remain salient in Korea.

One question to be addressed is why companies are reluctant to change unethical practices. Two potential explanations may answer the question. First, it has been long argued that a major goal of companies is maximizing profits and shareholders' wealth. Many Korean managers still tend to believe that business ethics is not directly related to the financial performance of companies although it may improve companies' reputation to general public. Second, business managers feel that current competition is stiffer than ever. As a result, many companies may force to resort to unethical practices. In other words, profits tend to override business ethics.

For these reasons, business ethics and its relation with corporate financial performance have long been of interest to corporate management. A better understanding of the association between corporate business ethics (CBE) and corporate financial performance (CFP) would provide managers with invaluable implications. However, it has been controversial that there is positive association between the level of corporate ethics and the financial performance of the company. Prior studies have argued that a substantial number of business executives believe that business ethics would improve long-term profitability of companies (e.g. Lee and Yoshihara (1997); Verschoor (1998)). Hence, if a substantially positive relationship can be discovered, it would militate for the level of overall business ethics.

To date, the extant studies in the literature have focused on the relationship between

CFP and CSP. Since the 1980s, a series of papers have documented the link between CSP and CFP (e.g. Cochran and Wood (1984); Aupperle *et al.* (1985); Spencer and Taylor (1987); Preston and O'Bannon (1997); Griffin and Mahon (1997); McGuire, Sundgren and Schneeweis (1998); Stanwick and Stanwick (1998); Moor (2001); Ruf *et al.* (2001); Simpson and Kohers (2002); Johnson (2003); Orlitzky *et al.* (2003); Orlitzky (2005)). Cochran and Wood (1984), and Spencer and Taylor (1987) report favorable relationship between CSP and CFP. Many other studies show mixed relationships. One possible explanation for the weak relationship between CSP and CFP is the multiple dimensions used to measure the level of corporations' social performance. For example, a number of studies have used *Fortune* survey of corporate reputation as a proxy of CSP. Other studies have used the Kinder, Lydenberg, Domini (KDI) index as a measure of CSP. Another issue identified in these studies is various measures of corporate financial performance (i.e. net income, earnings per share, return on equity, return on assets, risk and price). In prior literature, however, many measures for financial performance are unclearly specified.¹

Another issue with respect to the relationship between CSP and CFP is the direction of the causality. Despite many studies have documented bidirectional link between CSP and CFP, the direct causality between two variables is still unclear (e.g. Ullman (1985); McGuire, Sundgren and Schneeweis (1998); Waddock and Graves (1997); Orlitzky *et al.* (2003); Orlitzky (2005)).

It has been well documented the close link between corporate social performance (CSP) and business ethics (BE). However, although corporate social performance overlaps corporate ethics, each has distinctive conceptual properties. For example, Epstein (1987) addresses that business ethics and corporate social performance can be envisioned as overlapping circles sharing common conceptual space. That is, each of them

¹For example, a size unadjusted net income is significantly affected by the size of the company. An earnings per share may change on the basis of the number of share while the fundamental profitability of the firm remains unchanged.

has distinctive properties. Morris (1997) documents that business ethics influences corporate social performance. That is, ethical companies show better social performance.

Despite many studies have been documented regarding the relationship between CSP and CFP, and positive association between CSP and BE, the link between corporation's financial performance and its commitment to business ethics has rarely investigated. One possible explanation for the reason is that unlike CSP measures there is no easy way to measure the level of ethical commitment since a significant portion of ethical commitment of management including internal control of organization is unobservable to outside stakeholders. Hence, there is no widely used source of measuring the level of corporate business ethics. Thus, it will be worthwhile if we extend prior analysis to provide the link between the measure of ethical commitment and the factors of firms' financial performance and/or corporate valuation.

Anecdotal evidences have provided that a variety of stakeholders including investors, corporate managers, customers, suppliers, employees, researchers, and government policy makers have been interested in the relationship between ethics and profits (e.g. Vogel (1991); Verschoor (1998); Verschoor (1999); van der Merwe *et al.* (2003); Kulshreshtha (2005)). Vogel (1991) comments that if companies' managers do not behave ethically they will be punished in the form of customer and employee dissatisfaction, and media criticism. Thus, customers will stop buying and good employees will leave the companies. Verschoor (1998) is one of the empirical studies that investigate the relationship between business ethics and companies' financial performance. He reports that companies stating commitment to ethics show favorable corporate financial performance compared to other companies.

The purpose of this research is to determine whether business ethics is empirically related to financial factors and value of companies. In the present study, we take the initial step of comparing the association between the business ethics and corporate financial factors. We are particularly interested in the issues pertaining to the top managements' commitment to business ethics compared with corporate financial performance or cor-

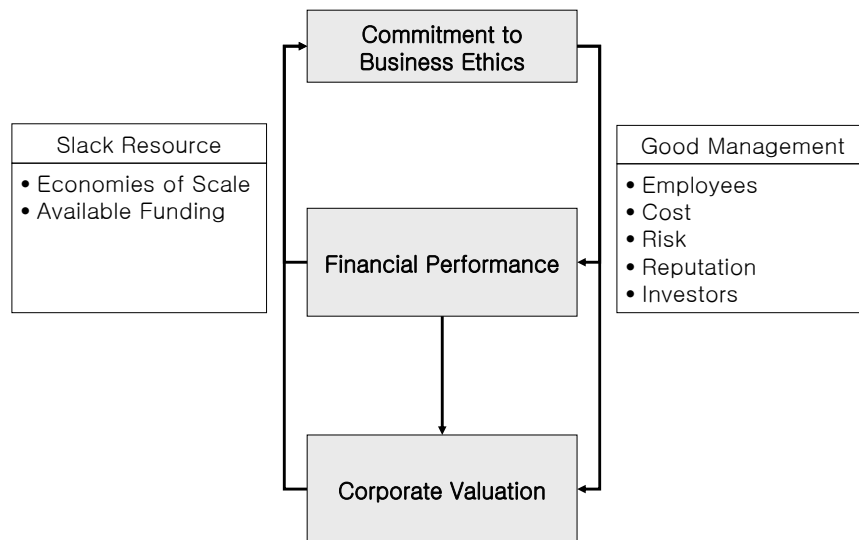
porate valuation. We will identify important factors in the context of business ethics that have significant impacts on the financial performance and/or corporate valuation.

The remainder of the paper is organized as follows. The next section describes the research design. Data, sample Selection and demographics of the respondents are presented in Section 3. The empirical result is examined in Section 4. Summary is provided in Section 5.

2 Research Design

2.1 Hypotheses

Figure 1: Association between CBE, CFP, and Corporate Valuation



If the commitment to ethics incurs substantial cost to the corporation, the relationship between the commitment to business ethics and financial performance will be negative (e.g. Aupperle *et al.* (1985)).

On the other hand, if the noise significantly affects the relationship between the commitment to business ethics and financial performance due to many intervening variables between the relation, the results will show insignificant link.

However, many anecdotal evidences have documented positive association between the commitment to business ethics and corporate financial performance. One line of theory suggests that ethical companies bear lower explicit and implicit costs including lower cost of capital, lower cost regarding employee relations, costs related to quality control, environmental costs, or litigation costs. In addition, ethical companies enjoy positive corporate reputation. Various studies have reported that corporate reputation is significantly positively related to corporate financial performance (e.g. Formbrun and Shanley (1990); Yoon *et al.* (1993); Little and Little (2000); Roberts and Dowling (2002); Neville *et al.* (2005)). Following these arguments, we expect positive association between the commitment to business ethics and corporate financial performance.

2.2 Survey

Survey studies are frequently used to gauge the managers' opinion on corporate business ethics. This method has been reliably used to assess the perceptions of corporate managers. This research is in line with prior survey studies in the field of business ethics. Survey questionnaires are prepared to construct an index of ethical commitment (ECI). Survey provides useful tool to measure the level of ethical commitment since the internal management control of corporation is hardly observable.

In order to avoid spurious results, the survey was carefully designed and implemented. To increase return rate, researchers visited the companies that agreed to participate in this survey study in advance. They delivered the questionnaires to the respondents' companies and collected self-administered questionnaires at a later time.² By doing so, researchers would less likely affect the outcome as well as they could main-

²This method can be affordable since the most major companies are concentrated relatively narrow area surrounding capital city Seoul in Korea.

tain sufficient sample size. In the meantime, we could collect complex information of companies. Respondents were allowed to return the questionnaire anonymously. The survey was administered directly to 391 corporate managers. 248 questionnaires are used for the study after controlling for missing values.

2.3 Measuring Ethical Commitment

There are no standardized instruments to measure the commitment to business ethics variable. For example, Verschoor (1998) uses the inclusion of a code of ethical conduct in the annual shareholder report as the measure of ethical commitment. To measure the level of ethical commitment of companies, we develop an index of ethical commitment (ECI). Each company is rated on multiple attributes considered relevant to ECI in prior literature. Table 2 provides details on the factors used in measuring ratings for ECI. They are rated 0 (no) or 1 (yes). The measure of ECI is computed as the sum of ethical commitment dimensions (e_i) as follows:³

$$ECI_j = \sum_{i=1}^k e_i \quad (1)$$

$$\begin{cases} ECI_j & \text{Ethical commitment index of company } j \quad (j = 1, \dots, n), \\ e_i & \text{Ethical commitment dimension } i \quad (i = 1, \dots, k). \end{cases}$$

Prior studies have documented theoretical foundation for ECI. Adam and Rachman-Moore (2004) report that majority of managers believe the *implicit method* is most influential on their ethical behavior. Ethical commitment dimensions include top management support (e.g. Trevino (1986); Schwartz *et al.* (2005)), culture (e.g. Genfan (1987); Sims (1992); Sims and Keon (1999); Sauser (2005)), ethical leadership

³Similarly, Ruf *et al.* (1998) develop an aggregate, systematic measure of Corporate Social Performance (CSP) index using the Analytic Hierarchy Process. They consider the relative importance of the dimensions by providing a weight (C_i) on each dimension as $CSP_j = \sum_j S_{ij}C_i$. In this study, we use equally weighted ethics dimensions to avoid subjective measurement error. However, we believe the results are qualitatively similar with or without relative weights.

(e.g. Brenner (1992); Carlson and Perrewe (1995)), open communication channels (e.g. Genfan (1987); Weeks and Nantel (1992)), and ethics training (e.g. Callan (1992); Dean (1992)).

In addition, surrogates for *explicit methods* of ethical commitment include code of ethics (e.g. Murphy (1988); Callan (1992); Verschoor (1998)), ethics hotlines (e.g. Weiss, Singer (1995)), ethics officers (e.g. Austin (1994)), ethics committees (e.g. Weiss (1994)).

On the basis of prior findings, we construct 11 dimensions for the measure of ethical commitment. Thus, ECI values from 0 to 11 were derived, representing the level of ethical commitment of companies. Table 2 shows descriptive statistics for ethics dimensions used to measure ECI.

2.4 Measuring Financial Performance and Corporate Valuation

Numerous studies have unclearly specified the definition of financial performance by viewing the financial performance overlaps the corporate valuation in the stock market. Although two concepts are closely related, they are analytically and conceptually discrete. We treat the corporate market valuation differently from financial performance.

Based on this presumption, the financial performance and corporate valuation are defined as follows:

Financial performance concerns the past and contemporaneous performance of business. That is, financial performance measures are mostly from companies' financial statements. These figures are the historical summary of companies' business.

Corporate valuation relates to achieving performance in the financial market. That is, the measures are primarily related to stock price in the capital market. In other words, they are related to the perceptions of the stakeholders outside companies such as security investors. This market-based measure is determined on the basis of expected future performance of companies.

This separation is considered appropriate for the following reason. Accounting and

financial theories and empirical studies have well documented the association between a company's market performance (i.e. stock price) and the financial performance of the company. The financial performance not only represents past and current financial output of the company but also reflects other information including the market's expectation of future profitability of the company.

Figure 1 postulate that there is substantial association between ethical commitment, financial performance, and corporate valuation. The paths in the model would examine (1) if firms that are more ethically committed show better financial outcomes, (2) if financial outcomes are positively linked to the performance in the capital market, and (3) if market participants expect the positive effects of ethical commitments on the future financial performance of companies.

Anecdotal evidences have documented that ethically committed firms show higher long term profitability rather than short term performance. The association between the ethical commitment and valuation factors would capture these empirical evidences.

Financial performance and corporate valuation variables are culled from the prior accounting and financial literature. Corporate financial performance is measured from accounting numbers including return on equity (ROE) and return on assets (ROA). In addition, the stock market performance is measured using various price variables and accounting ratios including price to earnings ratio (P/E), price to book value of equity (P/B) and Tobin's Q ratio (Tobin's Q). In the numerator of the P/E and P/B ratios, security price is based on the expected future earnings that market participants pay for (e.g. Ohlson (1995)). If market participants expect a higher future performance relative to book value, the P/B will show a higher value by incorporating the market's expectation in the numerator. In a similar vein, Tobin's Q also captures the relationship between a company's market and book value of equity. In sum, the higher the future profitability, the higher valuation ratios. These variables are commonly used to gauge firms' market performance.

Prior studies have documented potentially compounding effects of firm risk, growth,

and/or size. Hence, several measures are tested in the analysis as controlling variables including debt to asset (D/A), debt to market (D/M), capital asset pricing beta (beta), sales growth (Δ Sales) and total assets (TA).⁴ It is well documented that firm risk is negatively correlated with firm value. Hence, the first controlling measures utilized to assess firm risk are Debt to asset (D/A), debt to market (D/M), and market beta (beta). D/A and D/M measure the risk associated with financial leverage of the firm. As the amount of debt in a firm's capital structure increases, the riskiness of the firms increases. Therefore, corporate managers have incentive to meet creditors' expectations of companies' social responsibility or business ethics activities (e.g. Roberts (1992)). The capital asset pricing model beta is used to capture firm specific risk related to market volatility. If beta can captures firm specific risk factor, negative correlation would be expected between beta and ECI since a high level of ethical commitment may be considered as a better managed firm. Total assets (TA) reflects the size of the firm. Prior studies document that larger companies engage in a high level of corporate social performance since they receive a high level of attention from the stakeholders including investors, customers, employees, and government authorities (e.g. Dierkes and Coppock (1978); Trotman and Bradley (1981); Fombrun and Shanely (1990)). The slack economic resource theories also argue that larger companies can afford extra resource for ethical commitments (e.g. Waddock and Grave (1997)).

3 Data, Sample Selection and Demographics of the Respondents

The survey data for this study were collected from managers of companies listed in the Korean stock market. The sample is comprised of business managers of various industries as well as various levels within companies. A total of 284 usable questionnaires

⁴Alternative financial measures were tested as controlling variables. The results were qualitatively identical.

are collected to determine the extent of corporate managers' view on business ethics. Table 1 summarized general characteristics of companies and respondents. The survey was not restricted to any particular industries. The respondents were from numerous industry sectors. The companies split between manufacturing and non-manufacturing companies. Majority of respondents were from manufacturing companies (62.9%). And remainders were from Non-manufacturing companies. The managerial level and company size represented also span a wide range.

The sample consists of financial data from 2003-2004. Accounting data including earnings per share, book value, sales, long term debt, total assets, and number of shares were obtained from the TS2000 annual research files.⁵

Daily stock prices and market beta are from the 2005 KSRI Stock Database.⁶ 190 companies are listed on Korean Exchange while 58 companies are traded in the KOS-DAQ Market.

4 Empirical Result

Table 2 presents variable descriptions and descriptive statistics for the questionnaire used to measure the ethical commitment index (ECI). The result shows that more than half of managers agree with the statement that top managers regularly emphasize the importance of business ethics(57.3%). 48.4% of managers believe that ethical behavior is the norm of their companies. That is, business ethics is implicitly embedded in the companies' business philosophy. On the other hand, 38.3% of companies have the code of ethics that explicitly describe ethical philosophy of the company. Almost half of the companies have a discipline system through which unethical behavior is strictly punished. 38.3% of firms have an anonymous communication channel through

⁵TS2000 providing companies' financial data is prepared and maintained by Korea Listed Companies Association.

⁶KSRI Stock Database is made available by Korea Securities Research Institute.

which employees can report ethically questionable behaviors. The concerns for business ethics have significantly permeated to public interests during last decade. However, surprisingly enough, only one third of companies (35.9%) have formal ethics education, training, or workshops. About one third of companies regularly spend fund for social philanthropic expenditure (33.1%). Not many companies have ethics department and officers (29.8%), ethics helpline (24.6%), or ethics committee (16.1%). When managers are asked whether their companies have ethics evaluation system audited by independent party from the outside of the company, mere 12.1% of the managers agreed with the statement. On average, Korean companies seem to rely more on implicit form of ethical commitment than on explicit method of ethical commitment.

Table 3 summaries descriptive statistics for variables used in this study. Each company uses, on average, 3.819 implicit and explicit forms of ethical commitment. A table 3 also shows the financial performance variables and corporate valuation variables. Mean values of P/E (10.896) and P/B (0.726) are slightly lower than historic average of U.S. stock market.

Table 4 presents correlation coefficients for the key variables.⁷ The relation between ECI and financial performance variables is unclear. ROA and ROE show insignificant association with ECI at conventional level. The result implies that ethically committed companies does not necessarily show higher profitability. The association between ECI and D/M or D/A implies companies use more debt financing are more ethically committed. This result is not inconsistent with prior theory in a sense that the firms demanding for increased debts have incentive to lower cost of capital by providing more transparent information to the market and enhancing corporate reputation (e.g. Roberts (1992); Gelb and Strawser (2001)). If companies can achieve higher profits than the additional interest expenses on those increased debts and offset the increased financial risk due to the higher debt ratio, they would enjoy the increased financial leverage. Prior stud-

⁷We also computed Kendall's τ -b correlations. The result was not qualitatively different from the Spearman correlation.

ies show that the companies that engage in ethical commitment provide more public information. Hence, not surprisingly, the level of ethical commitment show positive association with the financial leverage. Prior studies have documented mixed association between beta and CSP. In this study, beta is significantly positively correlated with ECI (0.193). This result is in line with the arguments that riskier companies tend to focus on business ethics as a means of reducing firm specific risk (e.g. Trotman and Bradley (1981)).

Anecdotal evidence have supported the positive relationship between business ethics and corporate financial performance. For the most part, the result apparently supports our contention that the relation between ECI and valuation variables is positive. The correlation coefficients for P/E (0.175), P/B (0.286), and Tobin's Q (0.316) are significantly positive. A likely explanation for this association is that the market rewards the companies with higher ethical commitments through higher stock prices. Alternatively, we can speculate that more valued companies can afford to devote considerable commitments to business ethics.

There are two lines of theories pertaining to the direction of causality between ECI and financial attributes. On one hand, slack resource theorists argue that financially better performing firms have slack economic resources to invest in business ethics. On the other hand, good management theorists argue that there is high correlation between good management practices and ECI. Therefore, better ECI results in better financial attributes.

Table 5 presents the results of the regression analysis in various settings using ECI as the dependent variable and key financial variables as the independent variables. Following prior studies we used D/A, Sales growth, and Asset as controlling variables for leverage, growth and size respectively. We use one year lag between ECI (2005) and financial variables (2003) to test whether better financial performance or highly valued

companies leads to stronger ethical commitment.⁸ Panel A of Table 5 shows that ROE is insignificant at conventional level after controlling for leverage, growth and/or size.⁹ ECI is significantly associated with D/A ratio and total assets. Size shows significant association with ECI. Panel B and C of Table 5 present the results of the regressions using ECI as the dependent variable and valuation ratios as independent variables. The result shows how the market performance of companies influences the ethical commitments. As can be seen in Panel B and C, P/B and Tobin's Q are significantly related to ECI at the $p < 0.001$ level. We can postulate that companies that perform better in stock market than their competitors tend to invest more in the ethical commitments. In all panels of Table 5, lagged D/A and TA are significantly associated ECI of current year. One explanation is that larger companies focus on ethical commitment because they may receive a high level of attention from general public. The result also supports the slack resource argument.

The OLS regression results, reported in Table 6, are computed using key financial variables as the dependent variable and ECI as the independent variables after controlling for leverage, growth and/or size. We estimate the association between current financial variables (2004) and current ECI (2005). Panel A of Table 6 shows that ROE is not significantly associated with ECI after controlling for leverage, growth and size. As expected, ROE is significantly associated with growth of sales since controlling variable captures the profitability of companies. The positive association between ROE and D/A indicates that, not inconsistent with the finding from prior literature, the companies with higher leverage seem to achieve higher profits. Size shows no significant association with ROE. Panel B and C of Table 6 indicate that valuation variables are significantly associated with ECI.

The results reveal that firms with higher score in ethical commitment have positive

⁸ECI (2005) was based on the survey conducted in January 2005, which is matching with the financial data of 2004.

⁹We also used other variables for financial performance. The results were qualitatively similar.

impacts on companies' valuation (good management theory). That is, the association between the ethical commitment and companies' valuation is highly significant. This result is not surprising given that companies' good reputations through ethical business would have immediate impacts on their stock prices since market participants revise their expectation upward with respect to the future performance of the companies. However, the effects of ethical business on companies' financial output might exhibit longer lead-lag cycle, which is already incorporated in the stock price.¹⁰ In sum, companies valued high in stock market seem to emphasize on the importance of ethical commitment. This implication is not surprising for several reasons: (1) more stakeholders watch the company, (2) so, the stock price is more closely affected by the reputation, and (3) they need to hedge the risk (i.e. litigation, financial risk) through ethical business. In summary, the results seem to suggest that there is a virtuous circle between ethical commitment and corporate valuation. That is, highly valued firms lead to better ethical commitment because they have more resource and incentives to commit to business ethics. On the other hand, pertaining to valuation perspective, ethical commitment leads to outperforming other companies for various positive effects including improved morale of employees, lower cost, external reputation, and investor relations.¹¹ However, the initial findings from the study suggest that the association between CFP and ethical commitments is insignificant.

5 Summary

In recent years, there has been increased awareness of the importance of business ethics in many countries (e.g. Taka and Foglia (1994); Jackson *et al.* (2000)). The ethical perception of on country may be quite different from the common practice in

¹⁰Preston and O'Bannon (1997) show that there is time lag between CSP and improvement of CFP.

¹¹Similarly, prior studies document that the relation between SCP and CFP is bidirectional (e.g. Waddock and Graves (1997); Orlitzky *et al.* (2003); Orlitzky (2005)).

another country. Thereby, as the business environment is moving toward a global economy, understanding the business ethics in a international context has become a key to successful global business practices.

As discussed earlier, the connection between business ethics and economic benefit provides important implication to corporate managers. However, the association between business ethics and financial performance is not well documented compared to the association between corporate social performance and financial performance. This study has demonstrated the association between ethical commitment of Korean companies, and their financial performance and valuation in Korean stock market through the survey to the practicing managers. Although the analysis is conducted in Korean market, the result of this study offers insight into the implications of ethical commitment in global business environment.

In summary, the results draw several important implications to companies' managers and the stakeholders outside companies.

First, theories and empirical studies have well documented that companies' financial output is determinant of stock market performance. Thus, one distinct difference from the prior studies is that we treat the corporate market valuation differently from financial performance. Similar to the prior studies investigating the association between corporate social performance and market-based financial measures, we found significant relation between ethical commitment and corporate valuation. The results of the study lend supports to the belief that the relationship between ethical commitment and corporate valuation is bidirectional. However, it is not apparent that the impact of financial performance on ethical commitment is significant. The result may be caused by shorter time frame. We leave more in-depth analysis for future research.

Second, Korean companies more rely on implicit form of ethical commitment than explicit form of ethical commitment to enhance ethical behavior of employees. For the most common factor that used to instill ethical behavior is top managers emphasis on the importance of business ethics. Choi and Jung (2005) documents that compared

to U.S. companies, Korean and Japanese companies tend to use less formal ways for building ethical values into the organizations. Given the positive association between ethical commitment and financial variables, Korean companies need to make further effort to instill business ethics through more formal ways of ethical commitment.

The result, however, should be interpreted with caution. We report the association between the level of corporate business ethics, financial performance, and/or corporate valuation. Although we speculate the relationship between ethical commitment and financial performance for corporate valuation is bidirectional, the direction of causation is not completely investigated yet due to the limitation of survey data. We do not test how the level (change) of ECI leads to the change (level) in financial factors due to the data availability. A further analysis of causation between ethical commitment and corporate financial performance with a more concrete theoretical construct and complete data set would be a valuable area for the future study.

Overall, we believe this study shed light on the research of business ethics by providing a comprehensive survey results from the view point of practicing managers. Although further studies need to be conducted before derive the conclusion, the results of this study is useful in the sense that they contribute to an understanding of the link between business ethics and companies' performance. The finding can provide a new attempt for changing corporate business ethics emphasizing the companies' value.

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Table 1
Descriptive Statistics: Respondents¹

Descriptive Statistics	%
<i>Company Size: Number of Employees</i>	
1-499	46.8%
500-999	27.4%
1000-4999	19.8%
5000 and more	6.0%
<i>Industry</i>	
Manufacturing	62.9 %
Non-manufacturing	37.1 %
<i>Management Position²</i>	
Top Management	0.8%
Upper Management	26.2%
Middle Management	38.3%
Lower Management	32.3 %
Other	2.4%

Notes to Table 1:

¹ The number of total respondents is 248. The descriptive statistics are computed after considering missing values.

² Top management includes president, chairman of board, executive director, board member. Upper management includes functional department head and assistant director of department; Middle management includes deputy director of department; Lower management includes assistant manager; Other management includes nonmanagement personnel, supervisor, government officer.

Table 2: Variable Definitions for Ethical Commitment Index (ECI)

Variable Description		N	%
1.	Top managers of this company regularly emphasize the importance of business ethics	142	57.3%
2.	Ethical behavior is the norm of this company through the business philosophy	120	48.4%
3.	This company has a discipline system through which unethical behavior is strictly punished	119	48.0%
4.	This company has a code of ethics	95	38.3%
5.	In this company, employees can report ethical misconducts through an anonymous channel	95	38.3%
6.	In this company, ethics education, training, or workshops are devoted to enhance business ethics of employees	89	35.9%
7.	This company regularly use significant portion of profits as philanthropic expenditure	82	33.1%
8.	This company has independent ethics department and officers	74	29.8%
9.	In this company, employees can get help regarding business ethics through an ethics hotline or open communication channel	61	24.6%
10.	This company has an ethics committee	40	16.1%
11.	This company had an ethics evaluation system measured by independent party from the outside of company	30	12.1%

Notes to Table 2:

1 = Yes; 0 = No.

Table 3
Descriptive Statistics: Variables¹

Descriptive Statistics	N	MIN	MAX	MEAN	STD
ECI	248	0.000	11.000	3.819	3.005
AC	248	2.000	9.000	4.395	0.936
CC	248	1.167	9.000	3.527	0.962
NC	248	1.000	9.000	3.927	1.085
TA	248	25	179,727	2,607	13,757
Δ Sales	248	-0.874	1.534	0.150	0.248
Beta	248	-0.395	1.698	0.564	0.373
D/M.	248	0.014	38.400	3.076	4.999
D/A	248	0.031	0.955	0.476	0.205
ROA	248	0.002	0.134	0.029	0.023
ROE	248	0.003	0.439	0.063	0.055
P/E	248	0.773	88.209	10.896	13.542
P/B	248	0.117	3.832	0.726	0.548
Tobin's Q	248	0.261	3.042	0.846	0.305

Notes to Table 3:

¹ The number of total respondents is 248. The descriptive statistics are computed after considering missing values.

Where:

ECI : Ethical Commitment Index;

AC : Alternative Ethical Commitment Index 1;

CC : Alternative Ethical Commitment Index 2;

NC : Alternative Ethical Commitment Index 3;

TA : Total Assets in millions;

Δ Sales : % change sales (1 year) = $\frac{\text{Sales}_0}{\text{Sales}_{-1}} - 1$;

Beta : Capital Asset Pricing Model Beta;

D/M : Debt to Market Capitalization;

D/A : Debt to Total Asset;

ROA : Return on Total Asset;

ROE : Return on Common Equity;

P/E : Price to Earning Ratio;

P/B : Price to Book Value of Equity;

Tobin's Q : Tobin's Q Ratio = $\frac{\text{Liability} + \text{Market Value of Equity}}{\text{Total Assets}}$.

Table 4: Correlation Analysis among the Variables

	ECI	AC	CC	NC	Beta	D/M	D/A	ROA	ROE	P/E	P/B	Tobin's Q
ECI	1.000	0.422	0.251	0.265	0.193	0.012	0.160	-0.034	0.105	0.175	0.286	0.316
AC		<.0001	<.0001	<.0001	0.002	0.846	0.012	0.594	0.099	0.006	<.0001	<.0001
	0.402	1.000	0.450	0.465	0.138	-0.058	0.070	0.012	0.064	0.128	0.246	0.226
	<.0001		<.0001	<.0001	0.029	0.366	0.269	0.847	0.313	0.045	<.0001	0.000
CC		0.513	1.000	0.553	0.122	0.027	0.146	-0.001	0.100	0.110	0.256	0.255
	0.000	<.0001		<.0001	0.055	0.677	0.021	0.987	0.116	0.084	<.0001	<.0001
NC		0.502	0.611	1.000	0.061	0.030	0.097	-0.049	-0.011	0.124	0.126	0.139
	<.0001	<.0001	<.0001		0.342	0.640	0.126	0.442	0.867	0.051	0.048	0.028
Beta		0.120	0.095	0.048	1.000	-0.071	0.157	0.134	0.269	0.083	0.434	0.423
	0.001	0.060	0.136	0.449		0.265	0.013	0.035	<.0001	0.191	<.0001	<.0001
D/M		-0.015	0.022	0.028	0.007	1.000	0.791	-0.481	-0.072	-0.297	-0.457	-0.159
	0.011	0.813	0.736	0.657	0.915		<.0001	<.0001	0.258	<.0001	<.0001	0.012
D/A		0.109	0.181	0.113	0.180	0.635	1.000	-0.322	0.187	-0.124	0.097	0.377
	0.001	0.087	0.004	0.075	0.005	<.0001		<.0001	0.003	0.052	0.127	<.0001
ROA		0.000	0.021	-0.024	0.187	-0.343	-0.319	1.000	0.812	-0.556	0.327	0.219
	0.995	0.996	0.745	0.701	0.003	<.0001	<.0001		<.0001	<.0001	<.0001	0.001
ROE		0.026	0.083	-0.005	0.311	0.042	0.256	0.742	1.000	-0.652	0.431	0.438
	0.186	0.687	0.194	0.933	<.0001	0.512	<.0001	<.0001		<.0001	<.0001	<.0001
P/E		0.006	0.064	0.051	-0.017	-0.136	-0.093	-0.423	-0.446	1.000	0.335	0.255
	0.580	0.931	0.313	0.429	0.789	0.032	0.142	<.0001	<.0001		<.0001	<.0001
P/B		0.148	0.238	0.102	0.342	-0.168	0.094	0.273	0.334	0.221	1.000	0.896
	<.0001	0.020	0.000	0.108	<.0001	0.008	0.142	<.0001	<.0001	0.000		<.0001
Tobin's Q		0.150	0.238	0.101	0.322	-0.009	0.186	0.258	0.324	0.178	0.903	1.000
	<.0001	0.018	0.000	0.113	<.0001	0.883	0.003	<.0001	<.0001	0.005	<.0001	

Notes to Table 4:

Spearman correlations are reported in the upper triangular matrix, Pearson correlations are reported in the lower triangular matrix.

Table 5
Result of regressions using 2005 ECI as the dependent variable and 2003 financial variables as independent variables

Panel A: ROE						
	Intercept	ROE	D/A	Δ Sales	TA	Adj. R^2
Model 1	2.157***	0.234	3.052***	0.210	5.414E-11***	0.122
Model 2	1.858***	0.278	3.959***			0.0679
Model 3	3.782***	0.0298		0.565		0.002
Model 4	3.644***	0.127			6.583E-11***	0.0853
Panel B: P/B						
	Intercept	P/B	D/A	Δ Sales	TA	Adj. R^2
Model 1	1.518**	1.201***	2.551**	-0.214	4.847E-11	0.179
Model 2	1.166*	1.315***	3.318***			0.138
Model 3	2.703***	1.431***		-0.112		0.0834
Model 4	2.691***	1.245***			5.777E-11***	0.155
Panel C: Tobin's Q						
	Intercept	Tobin's Q	D/A	Δ Sales	TA	Adj. R^2
Model 1	0.695	2.175***	2.230*	-0.267	5.438E-11***	0.178
Model 2	0.373	2.182***	3.127***			0.124
Model 3	1.631**	2.502***		-0.146		0.0770
Model 4	1.599**	2.347***			6.248E-11***	0.162

Notes to Table 5:

⁺ $P < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Panel A: $ECI_{j0} = \alpha_1 + \beta_1 \cdot ROE_{j-1} + \beta_2 \cdot D/A_{j-1} + \beta_3 \cdot \Delta Sales_{j-1} + \beta_4 \cdot TA_{j-1} + \varepsilon_{j0}$

Panel B: $ECI_{j0} = \alpha_1 + \beta_1 \cdot P/B_{j-1} + \beta_2 \cdot D/A_{j-1} + \beta_3 \cdot \Delta Sales_{j-1} + \beta_4 \cdot TA_{j-1} + \varepsilon_{j0}$

Panel C: $ECI_{j0} = \alpha_1 + \beta_1 \cdot \text{Tobin's } Q_{j-1} + \beta_2 \cdot D/A_{j-1} + \beta_3 \cdot \Delta Sales_{j-1} + \beta_4 \cdot TA_{j-1} + \varepsilon_{j0}$

Where:

ECI : Ethical Commitment Index;

ROE : $\frac{\text{Net Income}}{\text{Book Value of Equity}}$;

Δ Sales : % change sales (1 year) = $\frac{Sales_0}{Sales_{-1}} - 1$;

TA : Total Assets;

D/A : $\frac{\text{Debt}}{\text{Total Assets}}$;

P/B : $\frac{\text{Price per share}}{\text{Book Value of Equity per share}}$;

Tobin's Q : Tobin's Q Ratio = $\frac{\text{Liability} + \text{Market Value of Equity}}{\text{Total Assets}}$.

Table 6
Result of regressions using 2004 financial variables as independent variables as the dependent variable and 2005 ECI as independent variables

Panel A: ROE						
	Intercept	ECI	D/A	Δ Sales	TA	Adj. R^2
Model 1	0.0523***	0.00223	0.0898**	0.0913***	-3.047	0.116
Model 2	0.0609***	0.000864	0.107***			0.0589
Model 3	0.0874***	0.00328 ⁺		0.104***		0.0845
Model 4	0.106***	0.00232			1.113E-13	0.007
Panel B: P/B						
	Intercept	ECI	D/A	Δ Sales	TA	Adj. R^2
Model 1	0.504***	0.0501***	0.040	0.0294	2.409E-12	0.0771
Model 2	0.486***	0.0528***	0.0798			0.0812
Model 3	0.511***	0.0543***		0.0453		0.0808
Model 4	0.527***	0.0503***			-2.578E-12	0.0842
Panel C: Tobin's Q						
	Intercept	ECI	D/A	Δ Sales	TA	Adj. R^2
Model 1	0.636***	0.0302***	0.193*	0.0342	-1.146E-12	0.0976
Model 2	0.649***	0.0284***	0.186*			0.102
Model 3	0.716***	0.0317***		0.0602		0.0894
Model 4	0.725***	0.0319***			-4.822E-13	0.0874

Notes to Table 6:

⁺ $P < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

$$\text{Panel A: } ROE_{j0} = \alpha_1 + \beta_1 \cdot ECI_{j0} + \beta_2 \cdot D/A_{j0} + \beta_3 \cdot \Delta Sales_{j0} + \beta_4 \cdot TA_{j0} + \varepsilon_{j0}$$

$$\text{Panel B: } P/B_{j0} = \alpha_1 + \beta_1 \cdot ECI_{j0} + \beta_2 \cdot D/A_{j0} + \beta_3 \cdot \Delta Sales_{j0} + \beta_4 \cdot TA_{j0} + \varepsilon_{j0}$$

$$\text{Panel C: } \text{Tobin's } Q_{j0} = \alpha_1 + \beta_1 \cdot ECI_{j0} + \beta_2 \cdot D/A_{j0} + \beta_3 \cdot \Delta Sales_{j0} + \beta_4 \cdot TA_{j0} + \varepsilon_{j0}$$

Where:

ECI : Ethical Commitment Index;

ROE : $\frac{\text{Net Income}}{\text{Book Value of Equity}}$;

Δ Sales : % change sales (1 year) = $\frac{Sales_0}{Sales_{-1}} - 1$;

TA : Total Assets;

D/A : $\frac{\text{Debt}}{\text{Total Assets}}$;

P/B : $\frac{\text{Price per share}}{\text{Book Value of Equity per share}}$;

Tobin's Q : Tobin's Q Ratio = $\frac{\text{Liability} + \text{Market Value of Equity}}{\text{Total Assets}}$.

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