

# Corporate Ethical Performance and its Consequences: Evidence from Indonesia

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## Article History

**Received:** 21 April 2019

**Revised:** 12 May 2020

**Published:** 30 June 2019

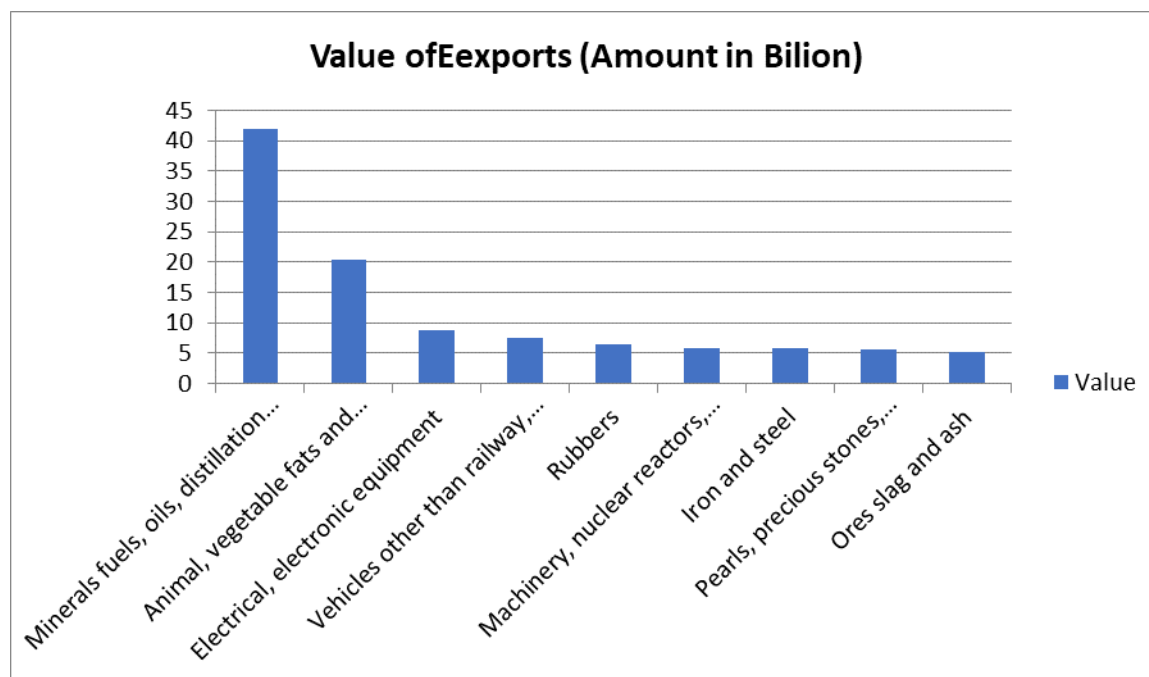
## Abstract

Growing environmental issues have made it compulsory for organizations to consider their impact on the environment. Business scandals have also pushed the organizations to be ethical in their business operations to build a positive reputation. Having considered the importance of the issue the present study attempted to examine the influence of corporate ethical performance on the CSR and corporate reputation. The study collected data by using the questionnaires and PLS-SEM used for data analysis. The study results signified that the ethics followed by organizations contribute towards the CSR and reputation. In addition, the results also postulated that the corporate governance gives strength to the influence of ethics on the CSR and reputation of an organization. Interestingly, governance appeared to have strong influence on the CSR and reputation.

**Keywords:** Corporate Social Responsibility, Reputation, Ethics, Ethical Climate, Resources

## Introduction

Corporate social responsibility is not a new phenomenon and developed over the years. Notably, it has moved from the planning and application phase to the assessment and monitoring phase. For governance of the CSR in 2010, International standard organization developed a certification named as ISO 26000. Besides, various organizations have published different reports regarding their CSR activities. It is an organizational approach which goes beyond the economic sense and considers the environment as a part of an organization (Ridho, 2018). Recent decade has seen various steps towards the CSR. For instance, British Govt. since 2006 has made it compulsory for all of the listed companies to report regarding the environment. Similarly, Swedish govt. since 2007 has also made it compulsory for the public sector organizations to publish their CSR report. Recently, Singaporean authority has also issued the regulations which are compulsory for all the listed organizations (del Rosario, 2015). Mining is an important sector in the economy and have a considerable contribution in the economic growth as well. It is related with the natural resources and CSR is also associated with the preservation of resources; therefore, it is worthy to study such topic in mining industry context. Similarly, the mining industry is also major industry in Indonesia and has a vital contribution in exports as shown in the below figure:



**Figure 1:** Indonesian Exports by Category

Source: Trading Economics (2019)

Indonesia is no more an exception with regard to the implementation of CSR. Indonesia is only ASEAN region country which is inclusive in the G-20 countries. It is expected that Indonesia will play a vital role in future. Besides, it is also worthy to note that the Indonesia is country with various organizations operating in natural resources business (Mining, and Forestry). Therefore, it is asked from the Indonesian companies to act more responsibly towards the environment (Ridho, 2018). Bearing in mind the importance of the CSR and corporate reputation the present study has considered its predictor which is corporate ethical performance.

Besides CSR, previously a study contended that examining the reasons, process and consequences which may lead towards the corporate reputation is very beneficial as it will provide the guideline regarding various steps to be considered to have a positive corporate reputation (Dell'Atti & Trotta, 2016). Therefore, the present study has also considered the corporate reputation as a potential outcome of the corporate ethical performance. The purpose of the present study is to examine the influence of corporate ethical performance on the CSR and corporate reputation. Additionally, study has also considered the role of the corporate governance as a mediator. Thus, following are the research objectives of the present study:

- 1) To determine the association between corporate ethical performance and corporate governance.
- 2) To examine the association between corporate governance and corporate social responsibility.
- 3) To examine the association between corporate governance and corporate reputation.
- 4) To examine the mediation role of corporate governance between the association of corporate ethical performance and CSR.
- 5) To examine the mediation role of corporate governance between the association of corporate ethical performance and corporate reputation.

Previously studies have established that corporate ethical performance influences the corporate reputation (Leiva, Ferrero, and Calderon, 2016; Branco and Rodrigues, 2006). However, the research in this domain is limited which ask for more research. Accordingly, the study significance lies in the fact that it provides the empirical evidence regarding how

the corporate ethical performance contributes towards the corporate reputation. Additionally, the study is significant as it provides the empirical evidence regarding the predictors of the CSR particularly from the organizations which deal with the natural resources. Therefore, it will serve as guideline for the organizational policy makers to consider their policies in order to have superior corporate reputation. Further, the study will also enable the policy makers to align their organizational policies and practices in a way which will result in CSR. The rest of the paper organized as follows; Literature review, methods, results and findings.

## **Literature Review**

### **Corporate Social Responsibility**

Corporate social responsibility is emerging topic worldwide and gained much importance across the business globally. Nowadays, organizations are facing a challenge of incorporation of the CSR in the business strategy. Besides this, the stakeholders are now asking the organizations to go for the application of the environment-oriented activities. There are number of definitions and conceptualizations of the CSR are present but still the understanding is not clear. The Institute of Directors, UK (2002) defined the corporate social responsibility as the related aspect of businesses and other firms which go beyond the legal obligation to save the environment. Additionally, the CSR is also inclusive of the consideration of the organizational impact on the environment for its betterment. It also covers that how do the companies deal with the employees, suppliers, customers and their communities they are serving. CSR has also been defined as a construct or concept which focuses on to define the association between companies and their larger influence on the society around it. Moreover, it also reshapes the role and responsibilities of the private businesses with that society as well (Keiner, 2008).

Previously, Kim et al. (2014) argued that the organizations have recently including the CSR as a part of their strategic orientation for the satisfaction of the stakeholders and to gain a competitive advantage over the other organizations. ElGammal, El-Kassar, and Messarra (2018) conducted a study and collected data from the SMEs in MENA region. They reported that the ethical corporate performance plays a significant role towards the corporate social responsibility. It affirms that the organizations with good corporate governance system tends better perform at CSR. Therefore, it is argued that the organizations with good corporate governance contributes towards the corporate social responsibility as all the policies are aligned with the CSR objective and strictly observed and evaluated on the progress made.

**H1:** Corporate governance is positively and significantly associated with corporate social responsibility.

**H2:** Corporate ethical performance is positively and significantly associated with corporate social responsibility.

### **Corporate Reputation**

Corporate reputation denotes to the perceptions of the public regarding the organization. It is regarded as a vital resource of an organization and offers an organization with value creation and helps to generate the positive image (Ponzi, Fombrun, & Gardberg, 2011). The topic has gained much attention but still there is no universally agreed definition as it has been defined by various authors for instance in words of Tench and Yeomans (2009) corporate reputation is composed of the planned and unplanned actions and message of organizations. In addition, it also consists of the strategy, philosophy and culture of an organization. All the positive and negative perceptions developed by an organization represent the corporate identity (Villafañe, 2004). Recently, it has been argued that the corporate identity denotes the stakeholder's perceptions about the organization (Olmedo-Cifuentes & Martínez-LeÓN, 2014).

Previously studies have established that the organizations which strictly follow the ethics while doing their business then to enjoy positive reputation in public (Onakoya, Moses,

Iyiola, Salau, & Ayoade, 2018). Literature points out that the ethical corporate performance and corporate reputation is positively associated. It is worthy to mention the finding of Leiva, Ferrero, and Calderón (2016) according to which the ethical performance results in the good corporate reputation. They further added that the organizations which follow the ethical practices and have positive attitude regarding their business they tend to enjoy positive and good corporate reputation. Organizations which demonstrate ethics in their doings also contribute towards the employee wellbeing which promotes them as a good employer. Additionally, it has become important as it offers the organizations with certain benefits along with a good reputation. Thus, it is argued that the organizations which invest in ethics they reap the benefits in form of good reputation. Hence it is hypothesized that:

**H3:** Corporate ethical performance is positively and significantly associated with corporate reputation.

**H4:** Corporate ethical performance is positively and significantly associated with corporate governance.

### **Corporate Governance as a Mediator**

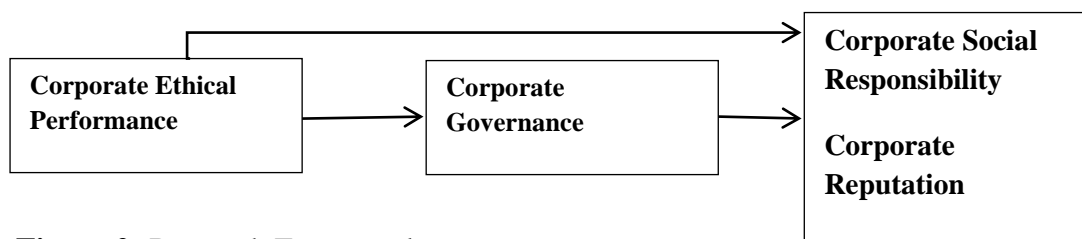
Corporate governance has been defined from various perspectives; anyhow, in general it is regarded as a function which plays a vital role in the distribution of the responsibilities and resources which influence the organizational strategic orientation and tends to generate value for an organization (Aguilera, Florackis, & Kim, 2016). According to one of the most prominent definition of the corporate governance it is “the system by which companies are directed and controlled” (Cadbury, 1992). Corporate governance also denotes to the system which address the ways in which financial suppliers of an organization are ensured about to get return on investment (Shleifer & Vishny, 1997). Notably, the external environment such as the economic condition of a country, judicial system and market highly influence such system. From another perspective, it is the set of laws and regulations which control the legal actions of an organization. Importantly, it has been argued that the absence of the corporate governance may result in various scandals, financial crisis and various types of structural issues within an organization (Claessens & Yurtoglu, 2013). Further authors also added that the financial crisis in 2008 reinforced the importance of the organizations which lacks the corporate governance it not only results in financial crisis for organizations but it affected the countries as well.

Corporate governance influences the CSR of the firms. Previously a study has provided evidence that the corporate governance is positively and significantly associated with the govt. ownership, family ownership, firm size and report of CSR (Habbash, 2016). Additionally, authors also confirmed that the corporate governance is one the reason to report the CSR activities of an organization. Corporate social responsibility is necessary to satisfy the stakeholders and to gain positive organizational image. Therefore, the organizations try to align their strategies with CSR and these strategies can be integrated with CSR objective by having good corporate governance (El Kayaly, 2014). Additionally, organization gets involved in the CSR in order to maintain their ethical identity as well. Corporate governance can be regarded as a system which is primarily focused on the stakeholders instead of the shareholders (Jo & Harjoto, 2012). Nowadays, promoting and maintaining a reputation of ethical organization has become much more important for organizations. Such approach has extended the scope of the organizations and their functions regarding their role in CSR. ElGammal et al. (2018) conducted a study and collected data from the SMEs in MENA region. They reported that the ethical corporate performance plays a significant role towards the corporate social responsibility and additionally, they also reported that the corporate governance is a significant mediator between association of corporate ethical performance and CSR.

**H5:** Corporate governance has a positive and significant influence on corporate reputation.

**H6:** Corporate governance is positive and significant mediator between ethical corporate performance and CSR.

**H7:** Corporate governance is positive and significant mediator between ethical corporate performance and corporate reputation.



**Figure 2:** Research Framework

## Methodology

The purpose of the study is to examine the influence of corporate ethical performance on the CSR and corporate reputation. Further the study has also considered the corporate governance as a potential mediator which explains the mechanism through which CEP influence the CSR and corporate governance. The present study used the quantitative approach.

Population is the targeted audience of the study. Therefore, the current study has addressed the mining industry of the Indonesia. It is selected because of its relationship with the natural resources and CSR is also associated with the environment as well. It is not possible to survey the whole population therefore a representative sample size has been selected. Due to the unavailability of the sampling frame the present study has used the convenience sampling to collect data. A total of 500 questionnaires were distributed among the employees related to the mining industry in Indonesia. Out of total distributed questionnaires only 300 were used as valid responses.

The data were collected by using the questionnaires comprising of two sections. One section consisted upon the demography of the respondents whereas the second section consisted upon the questions regarding the variables under study. All the questionnaires were adapted from the previous studies. Corporate reputation was measured by using four items questionnaire adapted from the previous study (Martens, 2019). Corporate social responsibility was measured by using six items instrument adapted from the previous study (ElGammal et al., 2018). Corporate governance was measured by using 11 items instrument adapted from previous study (ElGammal et al., 2018). Finally, the corporate ethical performance was measured by using 13 items measure. PLS-SEM has been used for data analysis.

## Results

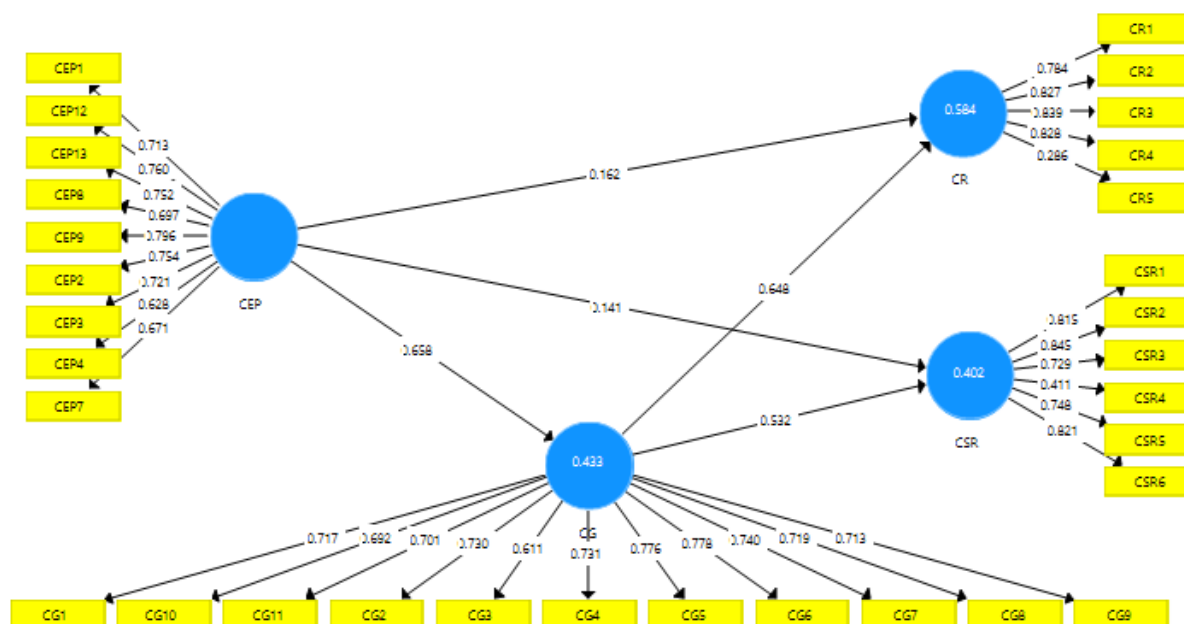
### Confirmatory Factor Analysis

First of all, a CFA was executed to calculate the scale convergent validity. There are three criteria to be checked, namely; factor loadings, composite reliability, and average variance extracted for this. Values for the factor loadings should be more than 0.7. However, generally, the factor loading values can be up to 0.5. The values for the composite reliability and average variance extracted should be greater than 0.8 and 0.5, respectively (Haier et al., 2010).

**Table 1:** Convergent Validity

<b>Constructs</b>	<b>Items</b>	<b>Loadings</b>	<b>Alpha</b>	<b>CR</b>	<b>AVE</b>
Corporate Ethical Performance	CEP1	0.713	0.885	0.907	0.522
	CEP12	0.76			
	CEP13	0.752			
	CEP2	0.754			
	CEP3	0.721			
	CEP4	0.628			
	CEP7	0.671			
	CEP8	0.697			
	CEP9	0.796			
Corporate Governance	CG1	0.717	0.907	0.922	0.519
	CG10	0.692			
	CG11	0.701			
	CG2	0.73			
	CG3	0.611			
	CG4	0.731			
	CG5	0.776			
	CG6	0.778			
	CG7	0.74			
	CG8	0.719			
Corporate Reputation	CR1	0.784	0.776	0.851	0.554
	CR2	0.827			
	CR3	0.839			
	CR4	0.828			
	CR5	0.286			
	CSR1	0.815			
Corporate Social Responsibility	CSR2	0.845	0.827	0.877	0.552
	CSR3	0.729			
	CSR4	0.411			
	CSR5	0.748			
	CSR6	0.821			

As per table 1, all the values for the factor loadings are greater than 0.5 and 0.7, which falls within the acceptable range. Similarly, composite reliability values of corporate ethical performance, corporate governance, corporate reputation and corporate social responsibility are 0.907, 0.922, 0.851, and 0.877, respectively. Furthermore, the value of average variance extracted for variables namely; corporate ethical performance, corporate governance, corporate reputation and corporate social responsibility are 0.522, 0.519, 0.554, and 0.552., respectively. Alpha values should be greater than 0.7. Alpha values for the corporate ethical performance, corporate governance, corporate reputation and corporate social responsibility are 0.885, 0.907, 0.776, and 0.827. All the values for the CR and AVE are within the acceptable range, which establishes the convergent validity of the scale. Following is the figure of confirmatory factor analysis:



**Figure 3** CFA

### Fornell & Larckers Criterion

After the convergent validity is established the next step is to assess the discriminant validity of the scale which also comes from the confirmatory factor analysis as well. In this regard there are different techniques being used. Table 2 is showing the values for the Fornell-Larcker criterion values. As per the parameter of this technique the values of the correlation of a variable must be greater than its correlation with other variables. Thus, discriminant validity is established.

**Table 2:** Fornell Larcker

	CEP	CG	CR	CSR
CEP	0.723			
CG	0.658	0.72		
CR	0.588	0.754	0.744	
CSR	0.491	0.625	0.56	0.743

### Cross Loadings

Table 3 is showing the values for the cross loadings. As per the parameter the values of cross loadings for a particular variable must be greater than the other variables in the same column. Findings reported in table 3 are fulfilling the conditions for the cross loadings to be valid, therefore it further strengthen the presence of discriminant validity.

**Table 3:** Cross-loadings

	CEP	CG	CR	CSR
CEP1	<b>0.713</b>	0.434	0.392	0.347
CEP2	<b>0.754</b>	0.485	0.413	0.382
CEP3	<b>0.721</b>	0.44	0.376	0.357
CEP4	<b>0.628</b>	0.429	0.379	0.278
CEP7	<b>0.671</b>	0.478	0.451	0.351
CEP8	<b>0.697</b>	0.502	0.41	0.361

**Table 3:** (Con.)

	<b>CEP</b>	<b>CG</b>	<b>CR</b>	<b>CSR</b>
CEP9	<b>0.796</b>	0.566	0.523	0.398
CEP12	<b>0.76</b>	0.461	0.444	0.334
CEP13	<b>0.752</b>	0.464	0.415	0.372
CG1	0.498	<b>0.717</b>	0.501	0.56
CG2	0.56	<b>0.73</b>	0.582	0.435
CG3	0.381	<b>0.611</b>	0.361	0.454
CG4	0.468	<b>0.731</b>	0.6	0.511
CG5	0.492	<b>0.776</b>	0.591	0.444
CG6	0.477	<b>0.778</b>	0.672	0.504
CG7	0.503	<b>0.74</b>	0.674	0.521
CG8	0.416	<b>0.719</b>	0.465	0.36
CG9	0.488	<b>0.713</b>	0.491	0.363
CG10	0.45	<b>0.692</b>	0.483	0.362
CG11	0.455	<b>0.701</b>	0.467	0.39
CR1	0.452	0.597	<b>0.784</b>	0.468
CR2	0.459	0.635	<b>0.827</b>	0.442
CR3	0.524	0.631	<b>0.839</b>	0.477
CR4	0.502	0.622	<b>0.828</b>	0.467
CR5	0.131	0.171	<b>0.286</b>	0.099
CSR1	0.435	0.588	<b>0.519</b>	0.815
CSR2	0.366	0.445	0.371	<b>0.845</b>
CSR3	0.415	0.437	0.411	<b>0.729</b>
CSR4	0.244	0.29	0.322	<b>0.411</b>
CSR5	0.36	0.531	0.48	<b>0.748</b>
CSR6	0.324	0.41	0.339	<b>0.821</b>

**HTMT**

After the convergent validity is established, then the discriminant validity of the scale was assessed. It was calculated to know the degree to which scale does not reflect the other variables in the questionnaire. There are two criteria for the assessment of discriminant validity. One is “Fornell-Larcker Criterion,” and the other one is “Hetrotrain-Monotrait Correlation Ratio.” The present study has adopted the latest technique, and according to the HTMT, the correlation between all the variables should be less than 0.85. As per table 3, all the correlation values for the variables are less than 0.85, which establishes the discriminant validity.

**Table 4:** Heterotrait Monotrait Ratio

	<b>CEP</b>	<b>CG</b>	<b>CR</b>	<b>CSR</b>
CEP				
CG	0.729			
CR	0.684	0.858		
CSR	0.57	0.704	0.67	



### Structural Equation Modelling

Table 5 is showing the direct relationships between the variables. As per the table corporate ethical performance found to be positively associated with corporate governance valued at 0.658. It means that 1% change in the corporate ethical performance will results in 65% change in the corporate governance. Additionally, results reported that the corporate governance is positively associated with the corporate reputation and CSR valued at 0.162 and 0.141. It means that the 1% change in corporate ethical performance will bring about 16% and 14% change in the corporate reputation and CSR respectively. It affirms that the when the organizations are following the ethical business practices it tends to enhance their positive public perception and also influence their role towards the society in a positive manner. More interestingly, corporate governance found to be associated with the reputation and CSR valued at 0.648 and 0.532. It affirms that 1% change in corporate governance will bring about major change in CSR and CR.

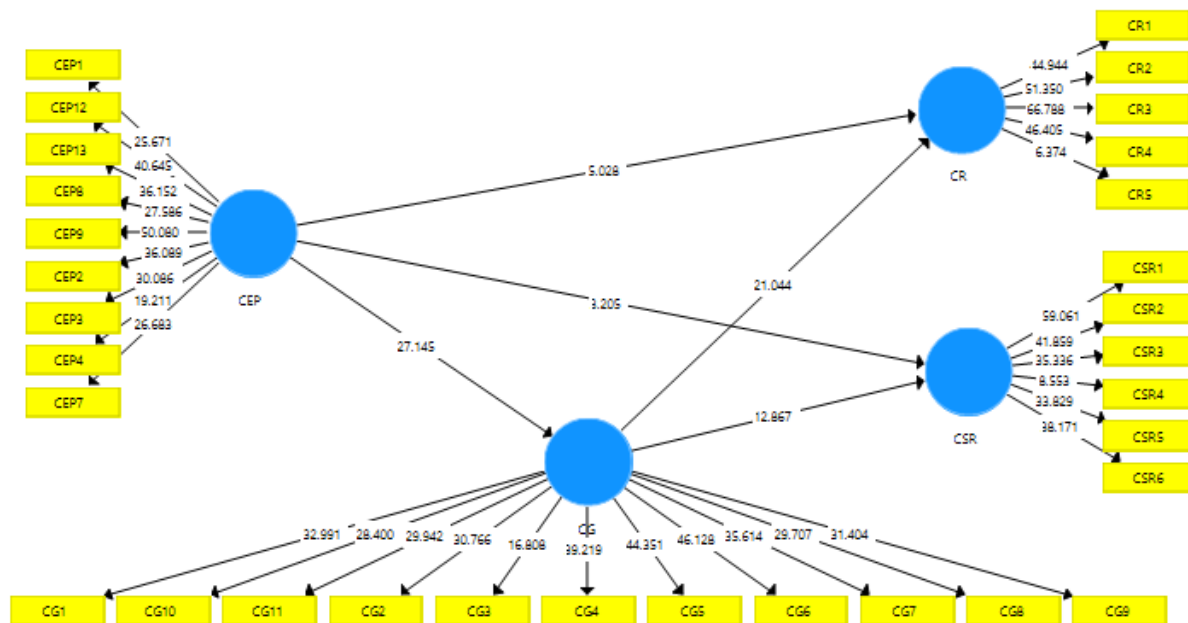
**Table 5:** Direct Effects

	Beta	SD	t value	p value	Decision
CEP -> CG	0.658	0.024	27.145	0	Supported
CEP -> CR	0.162	0.032	5.028	0	Supported
CEP -> CSR	0.141	0.044	3.205	0.001	Supported
CG -> CR	0.648	0.031	21.044	0	Supported
CG -> CSR	0.532	0.041	12.867	0	Supported

Table 6 shows the values for the mediation analysis. As per the findings reported in table 6, corporate governance is a significant mediator. It is worthy to note that the corporate governance significantly mediates the association between CEP and CR valued at 0.426 whereas it also found to mediate the relationship between CEP and CSR valued at 0.350 with a slightly low magnitude. Below figure shows the output of SEM.

**Table 6:** Specific Indirect Effects

	Beta	SD	t value	p value	Decision
CEP -> CG -> CR	0.426	0.028	15.489	0	Supported
CEP -> CG -> CSR	0.35	0.031	11.346	0	Supported



**Figure 4 SEM**

## Discussion and Conclusion

The study examined the influence of corporate ethical performance on the corporate reputation and CSR. The study further also considered the role of corporate governance as a mediator between the association of independent and dependent variables. Study hypothesized that the ethical performance by an organization predicts its reputation. The study results also supported the hypothesis and signified that the organizations following the ethics enjoy favourable reputation in public and employees as well. Study results also supported the hypothesis that the ethical performance of corporation significantly influences the CSR of organizations. It signifies that the organizations by following ethical considerations tend to be more careful regarding the environment which then increases their CSR. Results of the study were significant thus supported all of the hypotheses.

Based on the study findings it is concluded that corporate governance plays a vital role and serves as a mechanism to support the influence of corporate ethical performance on organization. Further, organizations can draw their corporate ethics to have better performance and build a positive image as they ethics serves as a guideline regarding what to do and how to do in a right way. Ethical issues are not only important for the organizations but they are also considered to be important for the employees as well. Ethics must be reinforced to have positive outcomes such as good public reputation and high market performance because if people see that a particular organization is strictly working on the business ethics then the people will buy from them as they consider that organization as a safeguard for their rights. It is also concluded that role of corporate governance must be acknowledge in any kind of policy following in any organization. From the stakeholders' point of view, it is concluded that the organizations must invest and go for the CSR practices in order to develop positive image among public. When the stakeholder's interest is safe, they will spread a good word about the organization and result in high market performance.

## Limitations and Future Directions

All of the hypotheses of the study are accepted and supported by the results. But there are still some limitations which can serve as a potential area for future research. It is to be noted that the current study has not considered any personality aspect. Therefore, it is recommended that the future studies must consider the personality traits as they are regarded as the key

driver for the behaviours. In addition, the future research may be longitudinal to measure the change in the behaviours of employees over a period of time. Future studies may also consider a comparative study in order to have valuable insights into the corporate ethical performance and CSR.

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