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Can an Ethical Work Climate Influence Payment Discipline?

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Abstract:

Purpose: All European companies are faced with the lack of payment discipline, which often affects even their survival. One of the key reasons for the lack of payment discipline is poor business ethics, which is primarily introduced with the subject of ethical climate in the literature. For this reason, we wanted to determine whether a company's ethical climate influences its payment discipline.

Design/methodology/approach: In the research, we used Arnaud's measurement instrument (2010) that helped us to identify six dimensions of ethical climate. The data about a company's ethical climate were later compared with the data about its payment discipline, calculated using the Dun & Bradstreet rating agency methodology. We included in the sample 273 Slovenian companies, which represented 9.1% of all companies invited to take part in the survey (2978 Slovenian enterprises with 10 or more employees).

Findings: We established that (among the six dimensions of the ethical climate) the dimension "moral sensitivity – the lack of norms of empathetic concern" had statistically significant influence on the average delay of payment, and the more significant for the company the lack of norms of empathetic concern was, the longer the delay of the payment to suppliers would be. Our conclusion is that the appropriate forms of the incorporation of training and education on ethical subjects into business studies may increase the payment discipline of companies.

Originality/value: The present study represents an important contribution to understanding the causes of payment defaults. The study also includes non-financial antecedents of payment discipline, which represents a new, important contribution of the research.

Keywords: ethical climate, ethical work climate, late payments, payment discipline

1. Introduction

The lack of payment discipline, which is defined as late payments and debtors' failure to settle their liabilities (Commission of the European Communities, 2009), is a massive problem all European companies encounter, and it causes the greatest difficulties mostly among small and medium-sized companies.

Heavy administrative and financial burdens are placed on companies because of excessive payment periods and late payments. Furthermore, such problems are the principal causes of insolvency affecting companies' survival; a further is significant job losses (Official Journal of the European Union, 2000: page 226). The European Commission's estimate that the lack of payment discipline affects the survival of 35% of companies is especially alarming (Commission of European Communities, 2009). More than 80% of sales are realised with deferred payments, which negatively affects operations of companies. Such effects are significantly increased during economic downturns, as it is then more difficult to access the financing (Official Journal of the European Union, 2011).

Slovenian companies mentioned intentionally late payments (Prašnikar, Pahor & Cirman, 2010) as the main reason for the lack of payment discipline. This phenomenon can be defined as an unfair commercial practice among companies (Commission of the European Communities, 2008). The reason for the lack of payment discipline is based on the personal interests of clients (due and outstanding claims are part of their working capital), as well as on liquidity problems, which can be temporary or long-term (in the case of long-term liquidity problems, it can cause the bankruptcy of companies).

The fact that Directive 2011/7/EU allows Member States to encourage "the establishment of prompt payment codes, which set out clearly defined payment time limits and a proper process for dealing with any payments that are in dispute, or any other initiatives that tackle the crucial issue of late payment and contribute to developing a culture of prompt payment" (Official Journal of the European Union, 2011: page 7) largely also indicates the expressed ethical component of lack of payment discipline issues.

Therefore, we conclude that one of key reasons for the lack of payment discipline is poor business ethics as well, in the literature principally described within the context of the subject

of the ethical climate (Treviño, Butterfield & McCabe, 1998), with the norms about solving ethical issues and the perceptions of practices and procedures with ethical content (Lemmergaard & Lauridsen, 2008).

The main aim of our study is to determine if ethical climate influences a company's payment discipline. This paper is divided into five different sections. Section 2 provides a brief theoretical background on unethical business practices and late trade payments. Section 3 explains the development of the hypothesis, and Section 4 outlines the methodology. Section 5 discusses results and implications for future research.

2. Theoretical Background

Companies are social actors, and they are responsible for the ethical or non-ethical behaviour of their employees (Victor & Cullen, 1988). Some companies can consider certain behaviour unethical, while others consider the same behaviour to be acceptable (Sims & Keon, 1997). Both companies and individuals have their own ethical principles that help them to shape their character (Cullen, Victor & Stephens, 1989). Ethical principles can be divided into the principles that come from the company (e.g. abuse of negotiation power) and the principles that come from the individuals in these companies (e.g. giving or receiving large gifts and bribes) (Bardy & Rubens, 2010). In our research, we focused on the business ethics of the lack of payment discipline among companies.

Poor business ethics appears in companies due to specific situations that often occur in their business operation and they use such situations to justify their unethical behaviour. Examples of such situations include time constraints, lack of money, conviction that the compromise in ethical behaviour can be decisive for the company's survival or failure, unclear limits between ethical and unethical behaviour, as well as hiding unethical behaviour from the public. In addition, companies often have no benefit from ethical behaviour (Morris, Schindehutte, Walton & Allen, 2002). The circumstances in which the companies operate are often hostile and highly challenging; therefore, it is difficult to overcome the tendencies to make ethical compromises, especially when resources are limited, and there is no room for errors (Longnecker, Moore, Petty, Palich & McKinney, 2006). In their operation, companies constantly encounter conflict between ethical acts and self-interest (Gottlieb & Sanzgiri, 1996). In cases in which self-interest is in conflict with ethical values, it is more likely that self-interest will prevail (Stigler, 1981). Because self-interest is given priority, companies develop so-called counter-norms. Unlike the norms of general convictions regarding appropriate and required behaviour, counter-norms are considered an inappropriate and socially unwanted behaviour, which are simultaneously accepted and considered necessary. Numerous business counter-norms promote morally and ethically questionable practices. We predict that the companies act in a context that dictates its own acceptable rules of behaviour (Sims, 1992), as

these practices are often accepted and rewarded (Jansen & von Glinow, 1985; Bertoncelj, 2010; Peterlin, Dimovski, Uhan & Penger, 2011). In this manner, we can also explain the fact that the companies in some activities are more unethical than in other activities. If the main competitor of a company operates successfully because of unethical activities, it is difficult for other companies to prioritise only the ethical measures; consequently, they could start to consider the unethical activities to be standard practice in the industry (Sims, 1992).

In the literature on the subject of business ethics, the ethics of companies is primarily presented with ethical climate (Treviño et al., 1998). Therefore, we included the construct of ethical climate in our research.

The ethical climate is part of company's climate and represents the norms about solving ethical questions, in addition to the perceptions of practices and procedures with ethical content (Lemmergaard & Lauridsen, 2008). The ethical climate of company is based on common perceptions of how the companies see and solve ethical dilemmas, and not on the feelings or relations that internal stakeholders (owners, management, and other employees) could have with the company (Wimbush & Shepard, 1994). Belak and Mulej (2009) call it a tool for understanding the companies' ethical environment located in right cerebral hemisphere.

Empirical research on the subject of companies' ethical climate mostly uses the typology for determination of ethical climate in company, which was developed by Victor and Cullen (1988), who upgraded it later (Cullen & Victor, 1993). That methodology was often criticised, both from theoretical and practical points of view, regarding (among others) the question of whether its model is actually two-dimensional or merely that both dimensions are linked (for example, Vaicys, Barnett & Brown, 1996; Wimbush, Shepard & Markham, 1997). On the conference of the International Association for Economy and Society, held in 2004, in a session about theory and method of measuring the ethical climate according to Victor and Cullen, it was concluded that a new theory and new methodology are needed to measure the ethical climate. According to Arnaud, her ethical climate index was her response to that need (Arnaud, 2010). Arnaud (2010) developed the methodology of measuring the ethical climate and called it the "ethical climate index". It is the new theory and new methodology of measuring the ethical climate with not two but four dimensions (two of them are further divided on two sub-dimensions).

Arnaud's (2010) dimensions of ethical climate index according are:

- collective moral sensitivity, consisted of
  - norms of moral awareness, and
  - empathetic concern,
- collective moral judgement, which is divided into
  - focus on self, and

    - focus on others,
- collective moral motivation, and
- collective moral character.

We analysed the ethical climate of companies according to Arnaud's methodology (Arnaud, 2010), following which we attempted to verify the impact of a particular dimension of companies' ethical climate on their payment discipline. In the next section, the development of the hypotheses is presented.

3. Hypotheses Development

We expected that the dimensions of ethical climate would influence payment discipline of companies. How and why these dimensions would have the impact on payment dimension is presented separately for each dimension.

3.1. "Collective Moral Sensitivity – Norms of Moral Awareness"

Moral awareness is the capability of individual to recognise the ethical problem: "If ethical questions do not reach the level of awareness of individuals, then the individuals will not recognise these ethical questions as ethical problem" (Rottig, Koufteros & Umphress, 2011: page 167). The recognition is crucial for all the unethical practices that have become widely present. Since the lack of payment discipline in some countries is quite widely present, people do not perceive it as an ethical problem, but as established practice. A similar situation is found in countries with high levels of corruption, in which the corruption is accepted as a standard type of behaviour (Budak & Rajh, 2012). "And if individuals do not recognise the ethical questions, they make the decisions giving the priority to other, unethical factors – for example economic factors" (Jones, 1991: page 380). If we are unable to see the ethical issue in late payments to our suppliers, then we shall conclude (based on economic benefits) that the lack of payment discipline is worthwhile, since, as a rule, it enables free credit financing to our business. Empirical results show that individuals judge problems more ethically if they are able to recognise the ethical dilemma (Singhapakdi, Rao & Vitell, 1996); therefore, we expected that the dimension of "collective moral sensitivity – norms of moral awareness" ethical climate would have a positive impact on payment discipline.

> *H1: The dimension of ethical climate called "collective moral sensitivity – norms of moral awareness" has a positive impact on payment discipline.*

3.2. "Collective Moral Sensitivity – Norms of Empathetic Concern"

"Empathy is the ability of individual to judge the influence their acts have on others" (Schminke, Arnaud & Kuenzi, 2007: page 176). In companies with high levels of empathy, the employees will be aware of consequences the late payments may cause to company's suppliers. Empirical results confirm that empathy has a positive impact on ethical behaviour (Arnaud, 2010), and we assumed that payment discipline was better in companies in which this dimension was more obvious.

> *H2: The dimension of ethical climate named "collective moral sensitivity – empathic ability" has a positive impact on payment discipline.*

3.3. "Collective Moral Judgment – Focus on Self"

"Moral judgement is the way the people define which reaction is (morally) correct in a particular situation" (Schlaefli, Rest & Thoma, 1985: page 319). "Collective moral judgement" can be defined as norms of moral judgement used to assess how to react to ethical issues. If the focus is on the subject of the decision, then we can talk about an egoism criterion of decision-making, i.e. about egoism (Weber & Seger, 2002). When individuals "assess ethical dilemmas considering the subjective judgement (for example: well-being, joy, happiness, power), then we talk about egoism" (Barnett & Vaicys, 2000: page 353), i.e. about the egoism criterion in decision-making. At that climate dimension, the primary factor of judgement is the interest of individual (Victor & Cullen, 1988), while the needs and interests of others do not matter, as norms prioritise the focus on self-interest (Cullen, Parboteeah & Victor, 2003). If that dimension of the climate is strongly expressed, then it indicates the readiness to do whatever is required to achieve the self-interests of individual (Flannery & May, 2000). We can expect that employees from such companies will not consider the consequences that late payments can have their suppliers. Employees from such companies will attempt to maximise their own interests, i.e. the maximum possible reward for success (which is usually associated with short-term financial results, regardless of how these have been achieved). The subject of moral judgement was the most frequent topic of research on ethical decision-making. Empirical research conducted so far has shown that the climates in which the egoism criterion of decision-making dominates have a positive impact on unethical behaviour (for example, Wimbush et al., 1997; Vardi, 2001; Peterson, 2002a, 2002b; Bulutlar & Öz, 2009). We expected that this dimension of ethical climate would have a negative impact on payment discipline.

> *H3: The dimension of ethical climate named "collective moral judgement – focus on self" has a negative impact on payment discipline.*

3.4. "Collective Moral Judgment – Focus on Others"

This dimension, as well as the previous one, refers to collective moral judgement. The difference between these two dimensions is that for the previous dimension the focus on self was significant, while in this dimension it is the focus on others. If we mentioned at the previous dimension that there was an egoism criterion of moral judgement, then we can say that the benevolence or principled behaviour is the subject in the judgement with focus on others.

In the case of benevolent behaviour, the benefit of others is prioritised (Barnett & Vacys, 2000; Wimbush & Shepard, 1994), which includes the immediate working team of individual, employees in company, other stakeholders and society in general among other factors (Barnett & Vacys, 2000). The individuals whose judgements are based on the benevolent criterion take into consideration all individuals or groups who could be affected by the decision, and make the decision that meets the best the needs of all, even if their own needs would remain unsatisfied. Meanwhile, the individuals who follow the criterion of principled behaviour in their judgements "consider that ethical decisions are the decisions in accordance with universal ethical principles, which are quite strict about what is good and what is wrong" (Barnett & Vaicys, 2000: page 355). Empirical research conducted thus far has shown that the climates based on the benevolent or the principled criterion of moral judgement have a negative impact on unethical behaviour (e.g. Wimbush et al., 1997; Vardi, 2001; Peterson, 2002a, 2002b; Bulutlar & Öz, 2009). We expected that companies where the judgement with focus on others is significant, during the process of adoption of financial policy, would take into consideration the consequences that their lack of payment discipline could affect to their suppliers; therefore, they are more disciplined payers than those companies where the judgement with the focus on self is significant.

> *H4: The dimension of ethical climate named "collective moral judgement – focus on others" has a positive impact on payment discipline.*

3.5. "Collective Moral Motivation"

Moral motivation describes the level to which the individual is motivated to make ethical decisions or how much prioritise the values, such as justice, honesty, honour and personal integrity, more than other personal values, such as ambitions, progression, power and personal fulfilment. "If the moral motivation is low, then ethical solutions of ethical issues are less appreciated than, for example, security, power, ambition" (Schminke et al., 2007: page 176). This means that the financial benefit in the form of free financing that the company gains from late payments will prevail in the companies with low moral motivation, and not the ethical decision on settling invoices in agreed deadlines. The dimension of the "collective moral

motivation" ethical climate are a result of the statistically important factor of ethical behaviour (Arnaud, 2010), and we expected that payment discipline would be better in companies in which this dimension was more emphasised than in the companies in which this dimension was disregarded.

H5: The dimension of ethical climate named "collective moral motivation" has a positive impact on payment discipline.

3.6. "Collective Moral Character"

"Moral character includes the persistence, strong ego, strength of conviction, courage and skills needed for implementation of morally correct decision and represents the ability to control their reaction to an ethical issue towards the ethical solution without allowing external factors to make us give up from our intended ethical reaction to a particular situation" (Schminke et al., 2007: page 177). Companies in which the dimension of "collective moral character" is emphasised are more likely to operate in accordance with moral commitments and social rules, which means that it would be reasonable to expect that the payment discipline of such companies is better. Arnaud (2010) proved that the dimension of ethical climate "collective moral character" had a statistically significant influence on ethical behaviour, and we supposed that it would also have a positive impact on payment discipline.

H6: The dimension of ethical climate named "collective moral character" has a positive impact on payment discipline.

4. Methodology

4.1. Data Collection

A total of 2978 Slovenian enterprises with 10 or more employees were randomly selected from the database of the Slovenian rating agency I d.o.o. (a partner company of Dun & Bradstreet). Persons responsible for accounting or financial data from these companies were contacted via email with a request to participate in an online survey. In addition to the answers about ethical climate, respondents only had to provide the name of the company, so that the data about a company's ethical climate could later be compared with the data about its payment discipline. Average payment delay was calculated using the Dun & Bradstreet rating agency methodology (average delay was calculated taking into account a sample of invoices). Our sample includes 273 Slovene enterprises, which represented 9.1% of all companies invited to take part in the survey.

4.2. Measurement Instrument – Translation, Conceptual and Functional Equivalence

Ethical climate was measured with the Ethical Climate Index (Arnaud, 2010). Translational equivalence was established using back-translation process. Conceptional and functional equivalence was confirmed by a team of experts in the field of business ethics.

4.3. Common Method Bias, Social Bias and Non-Response Bias

To avoid common method bias, the data concerning the average late payments was not acquired from the respondents; it was retrieved from the database of the Slovene rating agency I, d.o.o. In order to minimize social bias, the survey was anonymous. Non-response bias was tested with the t-test for two independent samples (early respondents & late respondents). No statistically significant differences were observed.

4.4. Average Late Payment Time

Of 272 companies, one was excluded from further processing because the rating agency data showed that its average late payment time was as much as 215 days.

4.5. Factor Analysis, Reliability, and Validity

The factor structure of Arnaud's (2010) instrument for measuring ethical climate was analysed using principal components analysis with varimax rotation. This factor analysis yielded six factors with eigenvalues over 1.00. The reliabilities of the single constructs were as follows: moral motivation (α = .953), moral judgement – focus on self (α = .895), moral sensitivity – empathic concern (α = .866), moral character (α = .853), moral sensitivity – the lack of empathic concern (α = .784) and moral sensitivity – awareness (α = .682).

These six factors explained 73.22% of the total variance. Five out of six factors were named according to Arnaud's (2010) proposal. Because our analysis yielded two factors for items that were supposed to yield one factor for moral awareness, we named one factor "moral sensitivity – moral awareness" and the other "moral sensitivity – the lack of empathic concern". The dimension "moral judgement – focus on others" was not obtained with factor analysis was that we had to exclude all statements with which we measured this dimension (Statements 18-22) due to overcorrelation with other dimensions.

We also excluded the following ten other statements:

2. People in my department recognize a moral dilemma right away.
5. People around here do not pay attention to ethical issues.
15. People around here are mostly out for themselves.
18. In my department it is expected that you will always do what is right for society.
19. People around here have a strong sense of responsibility to society and humanity.
20. What is best for everyone in the department is the major consideration.
21. The most important concern is the good of all the people in the department.
22. People in my department are actively concerned about their peers' interests.
31. People around here are confident that they can do the right thing when faced with moral dilemmas.
32. People I work with would feel they had to help a peer even if that person were not a very helpful person.

4.6. F. Testing of Hypotheses

Hypotheses 1 through 6 were tested with regression analysis using the enter method. Four control variables were used in this study: current ratio, debt-to-asset ratio, gross return on assets and enterprise size. Regression analysis results are presented in Table 1 (enter method).

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.290	1.588		.812	.418
Moral Sensitivity – Awareness (H1)	–.749	.464	–.097	–1.613	.108
Moral Sensitivity – Empathic Concern (H2)	.227	.464	.036	.598	.550
Moral Sensitivity – The Lackof Empathic Concern (H2)	.900	.464	.116	1.941	.053
Moral Judgement – Focus on Self (H3)	.322	.461	.042	.699	.485
Moral motivation (H5)	.381	.463	.049	.823	.411
Moral Character (H6)	–.229	.462	–.030	–.496	.620
Current ratio	–.030	.197	–.010	–.155	.092
Debt-to-asset ratio	4.567	1.631	.245	2.801	.877
Gross return on assets	–5.975	2.389	–.210	–2.501	.005
Enterprise size	.741	.438	.103	1.693	.013

H1: Hypothesis 1; H2: Hypothesis 2; H3: Hypothesis 3; H5: Hypothesis 5; H6: Hypothesis 6.

Table 1. Results of regression analysis – enter method

The single constructs (moral motivation, moral judgement – focus on self, moral sensitivity – empathic concern, moral character, moral sensitivity – the lack of empathic concern, moral sensitivity – awareness) were calculated as factor scores, using the regression method. With the regression model presented in Table 1 (enter method), 8.3% ($p < .05$) of the variability of average late payment time can be explained.

We repeated the procedure with a stepwise method as well. For that procedure, the inclusion of one variable with the highest correlation coefficient in the model at the first step is significant; we then gradually include the variables with the highest value of the partial F for variables in the model and outside of it. The differences between hierarchical methods can be classified according to the way the factors were included in the model (Boslaugh & Watters, 2008: page 272). With the stepwise method, we obtained the statistically significant model, and we can use it to explain 1.8% ($p < .05$) of the variability of dependent variable (average late payment time). The variable "Moral Sensitivity – The Lack of Empathic Concern" was included in the model and is statistically significant (Table 2).

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	5.210	.466		11.171	.000
Moral Sensitivity – The Lack of Empathic Concern	1.046	.467	.135	2.239	.026

Table 2. Results of regression analysis – stepwise method

Hypothesis 1, 3, 5 and 6 were rejected because no statistically significant positive connection exists between payment discipline and these four dimensions of ethical climate: moral motivation, moral judgement – focus on self, moral character, and moral sensitivity – awareness.

Hypothesis 2 was supported only partly because our analysis yielded two factors for items that were supposed to yield one factor named moral awareness and only one of them (moral sensitivity – the lack of empathic concern) had a statistically significant positive relationship with payment discipline.

We were not able to test Hypothesis 4 because, owing to their correlation with other dimensions, all statements measuring moral judgement – focus on others had to be excluded.

Current ratio, debt-to-asset ratio and control variables did not have statistically significant impacts on payment discipline. A significant negative relationship was observed between gross return on assets and average late payment time ($\beta = -.210$, $p < .01$) and a significant positive

relationship was observed between enterprise size and average late payment time ($\beta = -.202$, $p < .05$). However, both independent control variables gross return on assets and enterprise size were excluded from the model when stepwise method was used.

5. Discussion

Company's ethics are one of the key factors of its effectiveness. "A company with unethical behaviours cannot become (nor remain) permanently successful" (Belak, Thommen & Belak, 2014: page 84). We wanted to verify in our research how the ethics, which we measured with the ethical climate, influenced payment discipline in Slovenian companies with more than 10 employees. For research purposes, we used Arnaud's (2010) measurement instrument.

First, special mention should be made of the contribution in the validation of the methodology of measuring the dimensions of ethical climate (Arnaud, 2010), as it is a relatively new methodology and previously has not been sufficiently tested. Based on the answers obtained with Arnaud's measurement instrument (Arnaud, 2010), we identified six dimensions of ethical climate in Slovenian companies involved in our research:

- "moral motivation",
- "moral judgment – focus on self",
- "moral sensitivity – norms of empathetic concern",
- "moral character",
- "moral sensitivity – the lack of norms of empathetic concern", and
- "moral sensitivity – norms of awareness".

The author of methodology (Arnaud, 2010) also identified six dimensions, but our dimensions did not completely match hers. Within our research, we did not confirm the "moral judgement with focus on others" dimension (we confirmed only the "moral judgement with focus on self" dimension). In addition, instead of the "moral sensitivity – norms of empathetic concern" dimension, we identified two dimensions called "moral sensitivity – norms of empathetic concern" and "moral sensitivity – the lack of norms of empathetic concern".

We set six hypotheses in order to verify the impact of the dimensions above on the payment dimension. We could partly confirm only one hypothesis, because among all the identified dimensions only the dimension of "moral sensitivity – the lack of norms of empathetic concern" had statistically significant influence on the average delay of payment; the more significant the lack of norms of empathetic concern for the company was, the longer the delay of the payment to suppliers was. This is in accordance with our assumption that empathy (as the ability of the individual to judge on how his acts influence others) (Schminke et al., 2007: page 176) had a

positive impact on payment discipline. Consequently, the lack of norms of empathetic concern would have a negative impact on payment discipline. We could not confirm other assumptions associated with the impact of particular dimensions of ethical climate on payment discipline. We expected that all dimensions of ethical climate should positively influence payment discipline, but it is true that the author of the research mentioned that all dimensions of ethical climate should be included in the research, so we could verify the factor that had the greatest impact on the researched variable (Arnaud, 2010: page 352). Afterwards, we can attempt to influence the researched variable by changing the appropriate dimension(s) of ethical climate.

Considering the results of our research, we suggest the improvement of payment dimensions by weakening the dimension of ethical climate called "the lack of norms of empathetic concern". This can be achieved with training. In practice, ethical behaviour-related trainings shorter than three weeks has inefficient results, and the trainings longer than twelve weeks were no more effective than those that took between three and twelve weeks (Schlaefli et al., 1985). Taking into consideration these findings, it would be necessary to find appropriate forms of the incorporation of ethical behaviour-related training in business studies (in the cases in which such contents have not yet been included in curriculum). In this way, the moral judgement of future managers and financiers would be improved. In contrast, training with ethical content intended for current generations in management studies could be state-subsidised.

In the case of any research in the future, we propose comparisons between results obtained in different countries. Taking into consideration that there are considerable differences in payment discipline throughout Europe, any research on comparisons between the impacts of ethical climate in different countries with varying levels of payments discipline would be welcome. Within such research to be simultaneously conducted in more countries, it would be reasonable to verify the impact of national climate, defined as a "set of beliefs and values [that] distinguishes one nationality from the other and it is extremely stable" (Lažnjak, 2011: page 1018), on payment discipline.

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