THE RELATIONSHIP BETWEEN CORPORATE ETHICAL CLIMATE AND STAKEHOLDER MANAGEMENT

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Dedication

To Maarten, Annemarie & Camille

Acknowledgments

It is hard to believe that I am wrapping up this journey of over five years. I am fortunate to have had the support and encouragement of a terrific circle of colleagues, friends and family. I thank you all, but there are a few people to mention specifically.

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Abstract of Dissertation

The Relationship between Corporate Ethical Climate and Stakeholder Management

The purpose of this dissertation is to integrate the ethics and strategic management literature by exploring the relationship between corporate ethical climate and firm-stakeholder relationships, exploring the research question of how ethical climate variables impact corporate social action towards various categories of stakeholders.

This study informs the ethical climate research stream by reassessing the reliability of a recently developed measure of corporate ethical climate, the Ethical Climate Index (ECI)(Arnaud, 2006). The ECI is based upon Rest's (1986) theory of ethical decision-making. Rest suggests that ethical behavior results from a four step decision making process involving 1) moral sensitivity, 2) moral judgment, 3) moral motivation and 4) moral character. The ECI raises these steps to the collective level to measure the organizational climate for ethical decision making and behavior. This study also extends the business ethics literature by empirically testing the impact of ethical climate on overall stakeholder management.

This study contributes to stakeholder literature seeking to explore and explain the nature of relationships between management and stakeholders, specifically in this case, how firm ethical climate relates to managerial behavior toward stakeholders. Stakeholder and corporate social performance research generally support the proposition that firms are more effective and can gain strategic benefits when they maintain positive relationships with stakeholders (Margolis & Walsh, 2003; Orlitzky, Schmidt, & Rynes, 2003). A recent stream of research attempts to identify factors that affect the nature of firm-stakeholder relationships, and explain how they do so. Recent theoretical literature suggests that corporate ethical

culture can impact stakeholder salience (Jones, Felps, & Bigley, 2007). This study extends recent theoretical contributions and empirically explores the relationship between ethical climate and strengths and weaknesses in corporate social action toward stakeholders.

Following Mattingly and Berman (2006), a taxonomy of firm action toward stakeholders is divided into institutional and technical strengths and weaknesses, where the institutional environment is a source of normative expectations for a firm, and the technical environment is the source of resource exchanges. A structural equation model is used to test the relationship between ethical climate variables of collective moral sensitivity, collective moral judgment, collective moral motivation and collective moral character and these stakeholder categories. A significant positive relationship is found between collective moral sensitivity (in the form of moral awareness) and technical and institutional strengths in stakeholder relationships. These findings are discussed and managerial implications and directions for future research are also offered.

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Chapter 1: Introduction

A. Reason For the Research

In recent years, corporate scandals such as those that led to the downfall of Enron and WorldCom, and more recently Bear Stearns, have harmed a wide spectrum of corporate stakeholders: shareholders and creditors have lost money; employees have lost jobs; customers have lost services; and communities have lost sources of taxes and philanthropic investment. Following the scandals, legal reforms and public policy campaigns were initiated in order to prevent future harm. In these campaigns, the scandals were not simply attributed to individual wrong-doing, but rather, a phenomenon within many organizations resulting from a combination of lax corporate controls and corporate cultures that promote norms of greed and dishonesty. The Sarbanes-Oxley Act of 2002 sought to avert future corporate scandals and the resulting harm to stakeholders by increasing corporate reporting and disclosure requirements, and requiring codes of conduct for senior management. Moreover, the 2004 revisions to the United States Sentencing Commission Guidelines specified that firms must "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law" (USSG, 2004 § 8B2.1). Thus, in the aftermath of the scandals and the resulting legislation, many companies have charged corporate ethics and compliance officers with establishing firmer controls as well as assessing and improving organizational ethical culture or ethical climate.

The purpose of this dissertation is to assess the relationship between a corporation's ethical climate and its actions toward stakeholders. While some empirical studies have found an impact from a corporation's ethical climate on a specific stakeholder group, such as with employees (Jaramillo, Mulki, & Solomon, 2006), or the environment (Flannery & May, 2000),

yet there is a dearth of research assessing the impact of ethical climate on the broad spectrum of firm-stakeholder relationships. This is an important consideration in stakeholder research because, as stakeholders will often have competing interests, a key to managing stakeholder relationships is the manner in which a firm balances the inherent tensions between various stakeholder groups. Thus this dissertation extends two streams of academic research: the literature on ethical climate and the stakeholder management literature. Moreover, this research is relevant to an important debate ongoing among practitioners regarding the changing goals of corporate ethics and compliance programs.

One minor contribution this dissertation makes to the research on ethical climate is to provide further assessment of the reliability of a recently developed measure of ethical climate. The Ethical Climate Index (ECI) was developed by Arnaud (2006) as an improvement to the Ethical Climate Questionnaire (ECQ) previously developed by Victor and Cullen (1987, 1988). The ECI relies on Rest's (1986) theory of ethical decision-making to evaluate four dimensions that contribute to ethical behavior: 1) moral sensitivity that brings awareness of ethical issues; 2) moral judgment to set an intention to resolve ethical issues for the wider benefit; 3) moral motivation to prioritize values such as fairness and honesty above personal gain or advancement and 4) moral character to carry through with enacting the moral intention into behavior. The ECI raises the four dimensions of ethical decision making to a collective level so that the propensity for organizational ethical behavior is ascertained.

While the ECI measure has been applied to evaluate the relationship between an organizational ethical climate and ethical and unethical behavior within a firm, this study extends prior research by linking ethical climate to firms' actions toward stakeholders. Ethical climate, or a firms' collective levels of moral sensitivity, moral judgment, moral motivation, and moral character, is certainly relevant to how the firm interacts with and resolves conflicts

among its various stakeholders. When Rest uses the term "morality", he intends to refer to "a particular type of social value, that having to do with how humans cooperate and coordinate their activities in the service of furthering human welfare, and how they adjudicate conflicts among individual interests." (Rest, 1986: 3) Given this definition, it is a logical step to use Rest's theory as a basis to consider firm action toward stakeholders, because in managing stakeholder relationships, firms must coordinate their activities as well as resolve tensions between potentially conflicting stakeholder interests. The ECI raises Rest's considerations to the collective level of the firm, and measures the collective tendencies to be aware of potential conflicts, and to coordinate and adjudicate such conflicts.

This study also contributes to current stakeholder management research. Modern stakeholder research deals with the interaction between a firm (usually conceptualized as its top management) and various groups of stakeholders, such as shareholders, customers, employees, communities, etc (Freeman, 1984). A great deal of stakeholder research has addressed the strategic benefits that can arise from successful management of stakeholder relationships–this is referred to as the instrumental perspective of stakeholder management (Berman, Wicks, Kotha, & Jones, 1999). Recent meta-analyses of a large body of empirical literature have found that that there is generally a positive relationship (or a lack of support for a negative relationship) between corporate social performance (CSP) such as social action towards stakeholders, and corporate financial performance (CFP) (Margolis & Walsh, 2003; Orlitzky et al., 2003; Rowley & Berman, 2000). These scholars and others have asserted that given the vast amount of research addressing the CSP-CFP connection, future scholarship should move on to explore a new set of research questions. Such questions include how firms balance firm social responsibility activities, what might promote or constrain better stakeholder relationships, and how corporations actually manage these relationships. In other words,

research should consider what factors affect the relationship between a firm and its stakeholders, how firms develop relationships with stakeholders over time, what might impair firm/stakeholder relationships and how a firm can improve these relationships.

Therefore, within the realm of stakeholder research, scholars have begun an inquiry into factors affecting the development of firm/stakeholder relationships. This follows from the descriptive line of stakeholder research from Donaldson and Preston's (1995) three-part taxonomy. Rather than looking mainly at the normative "ought's" of how stakeholders should be managed, or the instrumental outcomes of stakeholder relationships such as firm financial performance, descriptive research asks questions such as "What is actually happening? What factors influence the relationship between a firm and its stakeholders? What brings a stakeholder to the attention of firm management, or what leads stakeholders to act?" Thus this research stream primarily seeks to describe what is actually affecting the relationship between firms and their stakeholders.

The current study falls within a descriptive line of stakeholder research as it seeks to identify how one particular factor—the organizational ethical climate--affects stakeholder relationships. Jones, Felps and Bigley (2007) propose that a firm's ethical culture affects how firms manage trade-offs among conflicting stakeholder interests. The current study takes this research a step further by 1) exploring how specific aspects of an organizational ethical climate can impact firm behavior toward certain stakeholder groups and 2) providing an empirical test of the impact of ethical climate on stakeholder relationships. Thus, this dissertation seeks to extend academic scholarship by exploring the theoretical and empirical bridge between two fields of research: ethical climate and stakeholder management.

This study has practical implications as well, specifically to those individuals within corporations that have recently been made responsible for assessing and developing an ethical

organizational climate—the corporate ethics and compliance officers (CECOs). This research reflects an ongoing debate in both academic and practitioner literature regarding a shift in goals for corporate ethics and compliance programs (Fort, Hess, & McWhorter, 2006). This shift in goals has played out in changes in the legal requirements for corporate ethics and compliance programs.

Legislation up to and including the Sarbanes Oxley Act of 2002 have charged CECOs with promoting a "command-and-control" compliance mentality (Tyler, Dienhart, & Thomas, 2008), where the goal of CECOs is mainly to install controls, training and monitoring in order to prevent unethical corporate behavior and to ensure legal compliance. This goal could be categorized as a negative incentive: action is undertaken to prevent bad consequences such as illegal behavior. This could be compared to the Google corporate motto "Don't be evil," which implies intent not to harm or do wrong. But that is not the same thing as saying "Do well and do good," which implies a more aspirational intent. This negative incentive leads to a "compliance mentality" among ethics and compliance officers. In other words, satisfying the legal requirements—the letter of the law—is all that is sought by some CECOs. Firm action that provides good consequences, i.e. corporate social action going beyond the requirements of the law, was often not seen to be within the purview of the CECO role. As will be discussed below, recent regulatory revisions to the Federal Sentencing Guidelines in 2004 aim to significantly change the nature of the goals of a corporate ethics and compliance program. The bottom line is that under the Guidelines, now CECOs should be responsible for establishing an ethical organizational culture—a more positive goal, involving promoting ethical values within the organization.

The results of this study will be interesting to CECOs because they provide some empirical support for the benefits of building an ethical organizational culture. Although the

empirical findings are mixed, there is some support for the idea that aspects of a more ethical firm climate, such as increased moral sensitivity among employees, may promote more beneficial relationships with key stakeholders. Specifically, firms with a climate of high moral awareness may be more likely to have stronger relationships with technical stakeholders such as consumers, employees, shareholders. They also may be more likely to have stronger relationships with institutional stakeholders such as the community and diversity groups. Given the findings related to the impact of moral sensitivity, this research may support recent efforts by CECOs to focus resources on activities that build moral sensitivity, a sense of community and positive moral identity within the firm (Fort, 2001).

Thus, this study lends some support to the idea that stronger ethical climates may strengthen relationships with stakeholders. One fundamental precept of stakeholder management literature is that strong stakeholder relationships can bring strategic benefits to a firm. Given this understanding, this study is an initial step in establishing whether promoting an ethical climate can strengthen wider goals of the firm. The findings of this study may provide support for ethics and compliance officers to take a more holistic view of their role in promoting ethical culture within organizations, including a more strategic view. As addressed in the final chapter, future research may bolster this holistic, strategic view by examining the links between ethical climate, stakeholder relationships, and firm economic performance. Additional future research topics are also addressed in the conclusion.

Given the implications of this study's findings for corporate ethics and compliance programs, a brief overview of the recent changes in the legislative and regulatory context governing these programs is provided. Thereafter follows a review of the relevant academic literature.

B. Legislative and Regulatory Context

As discussed above, a debate within practitioner literature focuses on the appropriate goals for corporate ethics and compliance programs and the officers that lead them. This debate stems from a recent change in the regulatory context which encourages the development of an ethical culture or climate within organizations. A short review of the historical background of business and economic regulations will show the development of the self-policing command-and-control compliance model from earlier efforts to regulate business, and the use of this model in legislative initiatives up to the Sarbanes Oxley Act of 2002. Thereafter, I discuss the revisions in the Federal Sentencing Guidelines in 2004 related to the new push for corporations to develop an ethical organizational culture.

There is little debate that corporate ethics programs, and the role of individuals responsible for ethics programs, have been shaped by the regulatory environment (Weaver, Trevino, & Cochran, 1999). Many scholars have examined the change in social expectations and legal requirements for corporations after the recent string of corporate scandals beginning with Enron and WorldCom (Fiorelli, 2004; Fort et al., 2006; Walker, 2004). Two regulatory initiatives that are frequently discussed are the Sarbanes Oxley Act of 2002 and the 2004 revisions to the Federal Sentencing Guidelines. The difference between these initiatives is striking. The Sarbanes-Oxley Act employs a long-standing regulatory model used in business or economic legislation. The regulatory model is, by definition, a combination of legal sanctions combined with a self-policing requirement, with particular outcomes explicit as part of the process. The modern form of this can be traced back for decades, most notably taking

its present form in the early years of the New Deal with the formation of the Securities and Exchange Commission. (Securities Act of 1933[1]; Securities Exchange Act of 1934[2].)

With respect to broadening the type of business activities covered by this regulatory model, this self-policing form of governance really took off in the decades of 1960's and 1970's, when socially transformative laws laid the groundwork for greater corporate responsibility to society, with a higher level of social accountability. There was a wave of development of new corporate regulatory bodies such as those in the areas of employment practices (Equal Employment Opportunity Commission, formed under Title IV of the Civil Rights Act of 1964), health and safety on the job (Occupational Safety & Health Administration, formed under the Occupational Safety & Health Act of 1970), environmental protection (the formation of the Environmental Protection Agency in 1970) and consumer protection (Consumer Product Safety Commission formed under the Consumer Product Safety Act of 1972). Each of these regulatory bodies was charged with setting specific requirements for firms to comply with, and firms were made responsible for their compliance and reporting. In terms of the self-policing element, a part of most of these regulatory regimes was the requirement that corporations establish grievance procedures, policies to hear employee/consumer/stakeholder complaints, programs for reporting illegal behavior and an ombudsman to process these reports, complaints and programs. In many cases, the role of ombudsman has transitioned into the role of corporate ethics and compliance officer (CECO).

In the 1980's, with the Reagan era of anti-regulation, the flow of additional requirements diminished but no substantive repeal of these statutory corporate responsibility standards occurred. Enforcement and compliance with the existing regulations became lax,

[1] Securities Act of 1933, 15 U.S.C.A. 77a (West 2005).

but broad social support for the government regulation of corporate responsibility did not diminish (Stevens, 2004). Nevertheless, with the lax enforcement came a wave of corporate scandals in the late '80s and early '90s, where Federal rules and regulations such as those put out by the Pentagon and the Federal Aviation Administration were flouted by firms such as government contractors and airlines (Pollack, 1990).

In 1991, as a result of the lowered enforcement practices by executive branch agencies, corporate enforcement standards were brought under the umbrella of the U.S. Federal Sentencing Guidelines for Organizations (the "Guidelines")(Fort et al., 2006; Trevino & Nelson, 1995). In an effort to provide increased incentives for ethical compliance, the Guidelines provide for reduced penalties for organizations that establish an effective program in compliance with minimum requirements specified by the U.S. Sentencing Commission.[3] The 1991 Guidelines specifically required: the adoption of standards and procedures aimed to reduce the prospect of criminal conduct; oversight by high-level personnel who do not themselves have a propensity toward criminal behavior; the communication of standards and procedures to all employees; ensuring compliance and enforcement through monitoring, auditing and disciplinary mechanisms; and if a violation does occur, updating the program's effectiveness.[4]

As a result of the 1991 Guidelines, many corporations established the position of compliance officer, developed codes of conduct, and began ethics & compliance hotlines to allow employees to communicate concerns. (U.S. Sentencing Commission, 1995). The compliance officer's goal was to prevent illegal activity and to ensure compliance with

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[2] Securities Exchange Act of 1934, 15 U.S.C.A. 78a (West 2005).

[3] U.S.S.C. section 8A1.2, App. Note 3(k).

[4] U.S.S.C section 8A1.2 App. Note 3(k)(1)-(7).

regulations. According to a 2002 survey of compliance and ethics officers, the heads of these programs have frequently been middle management lawyers reporting to the general counsel or non-lawyer managers reporting to other senior management and indirectly to the general counsel (Priest, 2002). While many of these programs may have had an ethics or values component, the programs have more often been investigative, enforcement or compliance-based. That is, the major emphasis has been on legal compliance with the requirements of the Guidelines, not on the development of an ethical climate (Weber & Fortun, 2005).

In the post-Enron era, there was initially a renewed emphasis on increasing corporate self-governance. In 2002, Sarbanes Oxley aimed to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws (Coustan, 2004). Sarbanes Oxley placed new responsibilities on CEO's and CFO's with regard to accounting and reporting standards and included rigorous requirements with regard to implementing codes of conduct applicable to senior officers, including the CEO. Academics and others have criticized the Sarbanes-Oxley legislation on at least two grounds: First, that it continued the prior "compliance mentality" by requiring corporate ethics and compliance officers to take a "command-and-control" approach to compliance, and did not reward efforts to address underlying ethical values in the corporate culture, which may be more effective in promoting good behavior (Tyler et al., 2008). Second, the extensive cost and effort to maintain the required corporate controls may amount to as high as 4% of GDP, costs which some argue may harm the global competitiveness of US firms or promote delisting from US stock exchanges (Zhang, 2005). Discussion continues about whether and how to decrease the reporting requirements and the resulting costs of Sarbanes Oxley.

As a response to many of these criticisms, a change in the debate occurred with regard to the appropriate goals of ethics and compliance programs. In 2004, the U.S. Sentencing

Commission amended the 1991 Guidelines to require that corporations establish compliance *and ethics* programs.[5] Although many practitioners had already considered their programs to involve ethics concerns, this is the first time that the concept of corporate ethics was prominently featured in the official text of the Sentencing Guidelines. In addition to the original compliance-based requirements, in order to qualify for reduced penalties an effective corporate ethics program must promote "*an organizational culture that encourages ethical conduct*"[6] and focuses on being a "*good corporate citizen*" (U.S. Sentencing Commission, 2004). Thus the emphasis of ethics and compliance programs has been raised to an organizational level, rather than at the micro-level where much CECO efforts have been focused.

The new guidelines also changed the 1991 Guidelines by requiring that a "high-level" individual be appointed to run the ethics and compliance program, that he or she must be given appropriate authority and resources[7], and must take a leadership role in promoting an ethical organizational culture. This individual must report to the board of directors (or a sub-committee thereof); train all employees, including directors and high level management; ensure that the programs motivate the employees to comply; and regularly evaluate and update the programs to ensure they promote the appropriate "organizational tone" (Fiorelli, 2004). Thus, the goal is no longer simply to prevent employees from engaging in illegal activities as with the 1991 Guidelines and the Sarbanes Oxley legislation. As a result of these changes, corporate ethics and compliance programs are supposed to be moving toward the goal of making fundamental changes in the nature of the organizational culture.

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[5] U.S.S.C. section 8B2.1.

[6] U.S.S.C Section 8B2.1(a)(2).

[7] U.S.S.C. Section 8B2.1(b) (2).

However, the Sentencing Commission Guidelines are not quite the same as a legal regulation in terms of how they are enforced. They are guidelines, and they become relevant when prosecutors are seeking to charge, or judges to sentence, corporations for wrong-doing. For this reason, many ethics and compliance officers may be slow to change from the compliance mentality. CECO's may continue to consider their role in promoting an ethical culture to be limited to the goal of preventing illegal behavior, as opposed to promoting good corporate citizenship that will generate responsible corporate social action toward stakeholders and the resulting strategic benefits. One aim of this study is to examine the empirical evidence brought about by this change in goals for CECOs under the new sentencing guidelines.

C. Structure of the Dissertation

This dissertation is organized as follows: Chapter one provides an overview of the study, the regulatory environment that sets the framework for the study, and the structure of the dissertation. Chapter two provides a literature review of both the stakeholder management research as well as the ethical climate literature to support the development of hypotheses and the overall model development. Chapter three lays out the methodology and research design for this study including the data sample, survey instrument and data analysis techniques. Chapter four provides the results of the data analysis. Chapter five includes the discussion of the results and conclusions. Relevant supporting materials are included in the appendices.

Chapter 2: Literature Review

In this chapter, I will review the theoretical development, as well as the empirical work within stakeholder management literature, including the recent theoretical contribution that suggests a link between ethical culture and stakeholder salience. Further, I will review the theoretical and empirical scholarship covering organizational ethical climate. The final section of this chapter reviews the development of the construct underlying the empirical measure to be used in this study, and develops the hypotheses to be tested.

A. Stakeholder Management

1. Foundations of Stakeholder Theory

Ed Freeman is given much credit for developing the stakeholder conception of a firm starting with the publication in 1984 of his book "Strategic Management: A Stakeholder Approach". Freeman in turn gives credit for the term "stakeholder" to work done at the Stanford Research Institute (SRI International, Inc.) during the 1960s (Freeman, 1984: 31). Foundations for the stakeholder concept can be traced back to Berle and Means' (1932) book on the corporation and its role in society, or even as far back as Adam Smith's The Theory of Moral Sentiments (Smith, 1759). Stakeholders are defined by SRI as "those groups without whose support the organization would cease to exist" (Freeman, 1984: 31) or by Freeman as "any group or individual who can affect or is affected by the achievement of the organization's objectives" (Freeman, 1984: 46). Stakeholders can include groups such as employees, suppliers, customers, communities and charities (Freeman, 1984: 25).

In his book, Freeman recognizes the ongoing changes that managers face in their external environment including globalization and increased competition, government influence on markets and industries, increased influence of the media, and activist consumer, social and environmental interest groups (Freeman, 1984: 10-22). Freeman argues that in this environment, managers will ignore these stakeholders at their own peril, as groups that are left out can prevent the accomplishment of the organization's purpose (Freeman, 1984: 52). As a response to these environmental changes, Freeman asserts the necessity for managers to manage relationships with stakeholders in a strategic manner in order to achieve organizational objectives. Freeman developed the famous "wheel and spoke" stakeholder map with the firm as the central focus, and its relationship with various stakeholders depicted by arrows to and from the various stakeholder groups. Freeman's presentation of the stakeholder management concept is an inherently business-minded, managerial-based view. He attempts to describe how the external environment affects the manager's ability to achieve organizational strategic goals. He proposes a construct and an outlook which allows managers to deal strategically with actors in the external environment.

Freeman's work on the stakeholder approach to strategic management led to a great deal of scholarship to develop the stakeholder theory of the firm. For example, Brenner and Cochran (1991) suggest that a stakeholder theory would be a descriptive and predictive tool which would explain how firms operate. How much choice the management has, and how well the firm survives are functions of how well the firm satisfies its stakeholders (Brenner & Cochran, 1991: 453). Hill and Jones (1992) suggested a stakeholder theory based on the stakeholder-agency concept, whereby the stakeholders that managers perceived to be most important would be paid most managerial attention. These scholars and others suggested that

the development of a stakeholder theory would integrate the field of business and society (Hill & Jones, 1992).

Since Freeman's 1984 book, hundreds of academic articles, books and presentations have developed the concept of stakeholder management. In fact, within a decade, so many authors had employed the terms "stakeholder', "stakeholder management", "stakeholder model" and "stakeholder theory" in so many different, and often contradictory ways, that in 1995, Donaldson and Preston wrote an article to "clarify and justify [the] essential content and significance" of the stakeholder concept (Donaldson & Preston, 1995: 66). Donaldson and Preston point out that there are three main types of stakeholder theory: Descriptive/Empirical, Instrumental and Normative. The Descriptive/Empirical stakeholder theory describes, and sometimes explains what corporations are and do with regard to their stakeholders, such as how corporations are managed, or how managers manage stakeholder relationships. Instrumental stakeholder theory predicts and tests connections between stakeholder management and the achievement of corporate performance objectives. Finally, Normative stakeholder theory addresses moral or philosophical concerns as to how corporations ought to manage their stakeholders.

Although Donaldson and Preston's clarification of the three methodological strands of stakeholder theory has been helpful to researchers, academic literature does not necessarily break down into these neat stakeholder categories. Indeed, many articles, attempt to bring a convergence to the literature by finding ways to weave some or all of the strands together into one theory (Jones & Wicks, 1999). Others have used one or more of these approaches to attempt to define the elements of this research stream further, including answering the questions Freeman left open such as how to identify who are the significant stakeholders to whom managers should give their attention. Mitchell, Agle and Wood (1997) take the latter

approach to explore a normative and descriptive theory of stakeholder identification and salience.

2. Defining Stakeholders

There have been a great number of definitions of stakeholders over time, addressing Freeman's (1984) question regarding stakeholders: "Who or What really counts?" Some of these definitions have been so broad as to include virtually anyone. The result was a construct that was "bewilderingly complex for managers to apply" (Mitchell, Agle, & Wood, 1997: 857), and there had been no consistency to allow the theory to develop. For example, Hill and Jones identify stakeholders as "constituents who have a legitimate claim on the firm" (Hill & Jones, 1992: 133). Starik defines stakeholders as those who "are or might be influenced by, or are or potentially are influencers of, some organization" (Starik, 1994: 90). Clarkson defines stakeholders as individuals who bear risk as a result of the firm's activities, and distinguishes between voluntary and involuntary stakeholders, depending upon whether the risk they bear was taken on by the stakeholder or placed upon them by the firm (Clarkson, 1995).

In response, Mitchell, Agle and Wood attempt to develop a model to clarify the stakeholders to whom managers should and do pay attention. Their model relies on three elements: 1) the Power of the stakeholder to influence the firm; 2) the Legitimacy of the stakeholder's relationship with the firm; and 3) the Urgency of the stakeholder's claim (Mitchell et al., 1997). The degree of salience of a stakeholder is identified based upon whether that stakeholder has one, two or three of the attributes. With the inclusion of the urgency element, their stakeholder salience model moves from a static into a dynamic model, and closer to the work of crisis management and issue-management scholarship. Urgency is not the only element in Mitchell et al.'s model that can change, however, and the change occurs not just as the presence or absence of urgency, but in its degree. Power and legitimacy can also

vary over time in quality, degree of perception and consciousness, as they are also socially constructed phenomena. Thus, the entire model is dynamic, and stakeholders can gain or lose salience on the basis of all three attributes of power, legitimacy and urgency (Mitchell et al., 1997).

While the Mitchell et al. (1997) model of stakeholder saliency is highly cited in theoretical literature, empirical stakeholder literature has not tended to use their model to define the stakeholder groups under study (cf. Agle, Mitchell, & Sonnenfeld, 1999). This is perhaps due to the questions regarding the orthogonality of the power and legitimacy constructs (Phillips, 2003). As discussed below, empirical stakeholder research has tended to employ generalized descriptive definitions of stakeholder categories including employees, shareholders, customers, community, environmental performance and diversity. These categories are found KLD STATS database which is frequently used by stakeholder researchers. The present study will use the KLD database for the endogenous variables.

3. Operationalizing Stakeholder Research with the KLD Database

KLD STATs is put forth by KLD Research & Analytics, Inc., the social investment research firm founded by the social investment firm Kinder, Lydenburg and Domini. KLD conducts research for investors on the social governance and environmental performance of the largest 3000 US companies by market capitalization. The KLD database has been criticized, because self-reports and qualitative judgments by outsiders are often used to evaluate the stakeholder relationships and because the scoring is "numerically crude" (Wood & Jones, 1995: 239). Nevertheless, often independent qualitative judgments are the best way to evaluate social relationships, and Wood and Jones concede that the KLD database is the "best-researched and most comprehensive" social performance database (Wood & Jones, 1995: 239). This is echoed by Harrison and Freeman (1999), who note that "the KLD database is an

excellent source of data" (Harrison & Freeman, 1999: 481). Recently, the KLD database has been called "the de facto research standard at the moment" for measuring corporate social performance in academic research (Waddock, 2003: 369). As with most data, the KLD database is not without its flaws, however, many scholars employing the KLD database to conduct empirical stakeholder research have developed techniques to optimize use of this data.

a. Stakeholder Relationships and Firm Performance

One line of empirical research in this literature is the attempt to determine the relationship between stakeholder management and firm financial performance. This research emerges out of the vast pool of research spanning 35 years attempting to find a link between the overall concept of corporate social responsibility and financial performance. For an overview/critique of the CSR-CFP research, see Griffin and Mahon (1997), Rowley & Berman, (2000), Orlitzky, Schmidt and Rynes (2003), Margolis and Walsh (2003) and De Bakker et al (2005).

One of the earliest published studies that specifically refer to "stakeholder management" rather than corporate social responsibility when evaluating a relationship to corporate financial performance is Berman, Wicks, Kotha and Jones (1999). In response to the debate over whether stakeholder theory is normative, instrumental or descriptive (Donaldson & Preston, 1995), Berman et. al. (1999) compared an instrumental "strategic stakeholder model", to a normative "intrinsic stakeholder commitment model" to determine which of these models are descriptively accurate, and to evaluate the effect of each model on corporate performance. Berman et. al. (1999) find empirical support for a corporate performance effect for the strategic stakeholder model but not for the intrinsic stakeholder commitment model. Thus, instrumental stakeholder models are found to drive strategy determinations, whereas normative stakeholder models do not.

A further contribution of the Berman et. al. (1999) paper is the operationalization of the stakeholder management construct using the KLD database. This database had been used before to operationalize corporate social performance (Graves & Waddock, 1994; Waddock & Graves, 1997), but was aggregated as a single measure, which does not isolate the effects of different stakeholder groups. The single measure use of the KLD data was critiqued because of a lack of theoretical relationship between the correlated measures as well as the mismatch of variables to measures of corporate performance (Wood & Jones, 1995). Further, the weightings (often equal) given to individual factors that make up an overall rating for a company are not conceptually explained. An improvement made by Berman et. al (1999) in the use of the KLD database was to break down the individual links for each of five different stakeholder groups: 1) employee relations, 2) diversity, 3) local communities, 4) the natural environment, and 5) product safety/quality (Berman et al., 1999: 495). This operationalization of stakeholder management has been used frequently in subsequent stakeholder research.

Following Berman et al., other studies continued to explore the instrumental relationship between stakeholder management and financial performance, often using the KLD database (Galbreath, 2006; Hillman & Keim, 2001; Ogden & Watson, 1999; Ruf, Muralidhar, Brown, Janney, & Paul, 2001). Ruf et al. (2001) used KLD data to explore the link between stakeholder relationships and financial performance over time. Specifically, they considered whether a change in financial performance in one year is related to change in stakeholder relationships in the next year, and vice versa, whether a change in stakeholder relationships in one year can have an impact on financial performance in the next and following years. The study found that improvements in stakeholder management as measured by the aggregate KLD ratings can have immediate as well as continuing beneficial financial impacts as much as three years following the improvements.

Margolis and Walsh (2003) note that the majority of the studies exploring the link between firm financial performance and stakeholder management (or CSR in general) find a positive relationship, or at least very little evidence of a negative link. Therefore, rather than further studies probing this link, they suggest a new descriptive scholarly agenda for CSR and stakeholder research, echoing the sentiments of Rowley & Berman (2000). The new descriptive agenda explores how firms are actually managing their relationships with stakeholders and society as a whole. Suggested research questions include what factors influence the dynamics of firm-stakeholder relationships, what antecedents trigger corporate action towards stakeholders or wider society, what makes stakeholders act to influence firms, and what are the results of such action in terms of the impact on society (Margolis & Walsh, 2003).

b. Descriptive Stakeholder Research

Recent research has taken on the new descriptive stakeholder research agenda, seeking to understand the phenomenon of firm-stakeholder relationships in its own right, including drivers of the dynamics of firm-stakeholder relationships. Thus, stakeholder management becomes the dependent variable in many cases. The current study will fit within this research stream as it will explore how the ethical climate of the firm drives firm-stakeholder relationships.

In this line of analysis, recent research has explored the relationship between managerial/organizational attributes and stakeholder management. For example, Starvrou, Kassinis, and Filotheou (2006) test an intrinsic stakeholder model (Berman et al., 1999), in the context of family-owned firms and downsizing decisions. Their hypothesis is that family-owned firms will intrinsically value the stakeholder relationship with employees and communities more than non-family owned firms, and therefore, will avoid downsizing. KLD

data was used to operationalize employee and community stakeholder relationships. Stavros and colleagues found that family business are less likely to downsize, and family firms are more likely to have strengths in employee and community stakeholder practices.

Noting that firms can vary in their stakeholder management over time (Ruf et al., 2001; Short, Ketchen, & Snow, 2005), Shropshire and Hillman (2007) conduct a longitudinal study of stakeholder management, seeking to determine the antecedents of change in stakeholder management. As with other studies, stakeholder management is measured using KLD ratings relating to community relations, employee relations, environmental performance, product safety/quality, and diversity. Shropshire and Hillman (2007) find that on the institutional level, the size and age of a firm increase the likelihood of significant change in its stakeholder management (Shropshire & Hillman, 2007: 80). Furthermore, consistent with institutional theory and the concept of isomorphic pressures, a stakeholder management shift by other industry members also increases the likelihood that an individual firm in that industry will change its relationship with stakeholders. On the organizational level, Shropshire and Hillman (2007) find that firms with high risk (high variability of returns) are more likely to change stakeholder management. Finally on the managerial level, Shropshire and Hillman found that as managerial discretion rises, it becomes more likely that a firm will change its stakeholder relationships in the next year.

A more in-depth discussion of the effect of managerial discretion on stakeholder management is given by Phillips and colleagues (2007). The concept of managerial discretion is defined as "latitude of managerial action" (Hambrick & Finkelstein, 1987: 371). In different environments, managers can face higher or lower levels of different types of constraints affecting their ability to act. One such constraint recognized by Hambrick & Finkelstein (1987) is organizational culture, such as ethical culture. The existence of organizational

constraints can impact the relationships managers build with stakeholders (Phillips, Berman, Johnson-Cramer, & Elms, 2007).

These articles engaging the descriptive stakeholder research agenda are relevant to the current study for two reasons. First, they provide both theoretical and empirical support for the idea that stakeholder relationships are impacted by managerial and organizational attributes. Secondly, they point out that organizational attributes such as culture or climate can be a constraint on managerial discretion to engage in corporate social action toward stakeholders. Before discussing the link explored in this study between ethical culture and stakeholder management, one additional point will be made regarding the operationalization of the stakeholder management construct using KLD data.

c. Taxonomy of Stakeholder Relationships

A recent innovation in operationalizing stakeholder management using the KLD data is the taxonomy devised by Mattingly and Berman (2006). They conceptualize the KLD data as "indicators of firm social action rather than as consequences or outcomes of action" (Mattingly & Berman, 2006: 22). In other words, the KLD data represent firm-level social action toward various stakeholder groups, which are part of firms' organizational processes, undergirded by principles, that result in specific social performance outcomes for firms and their stakeholders (citing Wood's organizing framework for research into corporate social performance (Wood, 1991)). Their purpose in developing this taxonomy is to "provide both a parsimonious description of corporate social action and a valid means to measure it" (Mattingly & Berman, 2006: 22). The endogenous variables in the current study are based on Mattingly and Berman's four-factor taxonomy to measure corporate social action toward stakeholders.

Mattingly and Berman (2006) used exploratory factor analysis to uncover the latent factor structures of the KLD data in order to develop a model that would reduce complexity in the data for future research. They used 12 KLD measures reflecting strengths and weaknesses for six key stakeholders: Community, Diversity, Product (Consumers), Employees, Environment and Governance (Shareholders). Because strengths in stakeholder categories tend to load on factors together with other strengths, rather than with weaknesses in the same stakeholder category, Mattingly and Berman found that it is inappropriate to subtract weaknesses from strengths to determine a total score in each category of stakeholders. Mattingly and Berman (2006) classified the 12 measures into the four distinct factors of the taxonomy: institutional strengths, institutional weaknesses, technical strengths and technical weaknesses. The division between Institutional and Technical stakeholders comes from Scott & Meyer (1983). The institutional environment is a source of normative expectations for a firm. The technical environment, on the other hand, is where the firm-stakeholder relationship involves resource exchanges (Scott & Meyer, 1983).

In Mattingly and Berman's taxonomy, the measures loading on the Institutional Strength factor were the strengths related to the stakeholder groups Diversity and Community, implying a broader, more normative conception of CSR. Strengths in the Diversity category relate to positive firm treatment of women, minorities, disabled and gay and lesbian stakeholders (see Appendix A for further detail on the KLD 2007 ratings criteria). Strengths in the Community variable relate to firm support (philanthropic and otherwise) of positive community development activities.

Mattingly and Berman found that the measures loading on the Institutional Weaknesses category include KLD weaknesses to the Community and the Environment. (Environmental strengths also loaded on the Institutional Weaknesses factor because it is so

strongly correlated with Environmental Weaknesses. However, Environmental Weaknesses loaded more strongly on this factor, so for the sake of clarity, Mattingly and Berman excluded Environmental Strengths from the factor analysis.) The Community Weakness and Environmental Weakness variables indicate negative firm actions toward stakeholders from the institutional environment. For example, Community Weaknesses would include controversies over investments, tax disputes and negative economic impact on communities, such as with lay-offs or plant closings. Environmental Weaknesses include problems such as high emissions or hazardous waste.

Measures loading on Technical Strengths in Mattingly and Berman's taxonomy are the strengths relating to stakeholders with whom the firm is involved in resource exchanges--Consumers (product), Shareholders (governance) and Employees. This is a narrower category of stakeholders related to business purpose. Strengths related to Products include quality and innovation. Strengths related to Shareholders include strength of transparency in reporting and limited compensation to CEO or board members. Strengths related to Employees include strong health and safety programs, retirement benefits, union relations and cash profit sharing.

Finally, measures loading on Mattingly and Berman's Technical Weakness category reflect weaknesses in corporate social action toward Employees, Diversity, Consumers and Shareholders. Weaknesses toward Employees would include safety controversies, pension and benefit-related concerns and poor union relations. Weakness related to Diversity would include non-representativeness of the workforce and involvement in litigation or other diversity controversies. Weaknesses toward Consumers would include controversies regarding product safety or marketing, and antitrust violations involving pricing issues. Weaknesses related to Shareholders include involvement in accounting controversies, non-transparent reporting and high compensation to the CEO or board members.

Mattingly & Berman suggest that their taxonomy of corporate social action is intended to resolve some of the definitional disagreement regarding corporate social responsibility, including which ends or outcomes are more desirable. Their contribution is a taxonomy and procedure for using the KLD data as an independent or dependent variable, to help future researchers to accumulate knowledge on the causes and consequences of corporate social action. For example, noting that the values of managers may not always be the most important drivers of corporate social action, Mattingly and Berman suggest future empirical research into the impact of "habits and practices embedded deeply in a firm's culture over time" on stakeholder relationships (Mattingly & Berman, 2006: 41). The current study pursues the suggested line of research, as the independent variable is the ethical climate of the firm and the dependent variable is based on Mattingly and Berman's taxonomy of corporate social action towards stakeholders.

In conclusion, as the above research summary demonstrates, since its inception 25 years ago and particularly in the last decade, there have been very many refinements in how stakeholder relationships have been conceived, operationalized and applied in theoretical and empirical research. Scholarship has supported evidence of several antecedents and outcomes related to stakeholder management. Furthermore, we have a deeper understanding of the dynamics of stakeholder relationships. As noted above, weaknesses inherent to the stakeholder data and in operational approaches are being continuously improved in subsequent research, and the current methods of operationalizing stakeholder relationships using the KLD data demonstrate significant advancement from prior academic research. It is clear that the stakeholder concept shows a great deal of promise for future research. As the theoretical background and operationalization of the stakeholder concept is further refined and developed, it could very well turn out to be the unifying concept behind business and society

scholarship (Hill & Jones, 1992). Before moving on to a review of the ethical climate literature and the development of hypotheses for the current study, the next section discusses the theoretical link between ethical culture and stakeholder management.

B. Ethical Culture and Firm-Stakeholder Relationships.

In line with the burgeoning exploration into the dynamics and antecedents of stakeholder relationships, a recent theoretical article considers how ethical culture could affect the level of attention that firms give to stakeholders (Jones et al., 2007). This section reviews Jones et al.'s contribution which sets a foundation for the model and hypotheses in the current study.

Recognizing that organizational context influences the actions of management and echoing a call for identifying organizational level factors that can predict how firms manage stakeholder relationships, Jones, Felps & Bigley (2007) suggest that a firm's ethical culture can impact firm-stakeholder relationships. Drawing on ethical theory, Jones et al. devise a new typology of ethical culture called Corporate Stakeholder Cultures, and make propositions about how these culture types will impact the theory of stakeholder salience (Mitchell et al., 1997). Their typology can be boiled down to three levels: 1) an egoist culture focuses on a pursuit of self interest, where no other stakeholder interests are considered important; 2) a culture of limited morality which is essentially a shareholder-focused culture, and where other stakeholders may be considered for instrumental reasons; finally, 3) a culture of broad morality is one in which a genuine, intrinsic concern for all stakeholders is shown.

Jones and colleagues suggest that firm ethical culture can make a significant impact on predictions of stakeholder saliency, or "who or what really counts" to corporate managers (Jones et al., 2007: 150). The reason for this is that the stakeholder attributes determining

saliency (power, legitimacy and urgency) will be classified and weighted differently within firms having broader versus narrower types of ethical culture. Firms with a culture of broader morality are more likely to pay attention to a broader array of stakeholder interests, whereas cultures with limited morality are likely to have an instrumental view and consider only those stakeholders that contribute to the bottom line. Jones et al. weave together a normative and a descriptive account of stakeholder theory, and how it is affected by the firm's ethical culture. The propositions they make regarding the link between ethical culture and stakeholder management are incorporated in the development of the hypotheses tested in the current study.

Jones et al.'s work is groundbreaking because it is one of the first that specifically discusses how the ethical tone within the organization is a constraint or enabler impacting how a firm's relationship with stakeholders is managed. Specifically, the determination of "Who or What matters" can be impacted by the ethical norms and assumptions generally held by firm members. This moves the testing of stakeholder theory beyond the realm of the values of individual CEOs (as tested previously by Agle et al (1999)), to a determination of how the values of the firm as a whole can impact relationships with stakeholders. The Jones, Felps & Bigley (2007) article is one of the first to suggest a relationship between the two rich and longstanding research streams of stakeholder management research and organization ethical culture or climate.

This connection between stakeholder management and firm culture is important because firm culture, and particularly ethical culture, can operate as a constraint on the discretion of top management to change stakeholder relationships—as discussed by Phillips et al. (2007). The current study will take the concepts linking ethical culture to stakeholder management as presented by Jones et al. a step further by conducting empirical tests of the

relationship using a broader measure of organizational ethical climate. The next section will review the ethical climate literature, explaining the theory and empirical measures to be used and identify the hypotheses to be tested in this study.

C. Ethical Climate

In business ethics research, there is a twenty-year history of enquiry into organizational ethical culture or climate, and the impacts it has on behavior (Victor & Cullen, 1987, 1988). This section will review this literature, drawing out the theoretical differences between the construct of organizational culture versus that of organizational climate, explaining how an ethical climate is a sub-set of a broader organizational climate, and discussing the operationalization of the construct using empirical measures of ethical climate. Discussion of theory and measures will include the Ethical Climate Index (ECI) which is based on Rest's four-step ethical decision-making process. The ECI will be used for the exogenous variables in the current study. Finally the hypotheses to be tested in this study will be developed.

1. Organizational Culture versus Organizational Climate

An ethical climate is a type of organizational work climate. The term organizational climate has sometimes been used interchangeably with the term organizational culture (Schneider, 1990), and the two concepts are related as they "both describe employee's experience of their organizations" (Patterson et al., 2005: 380). Organizational climate and culture are both learned over time by firm members through the process of socialization. However there are important differences in how these terms are used in academic research. The study of organizational culture arose from the field of anthropology. Organizational culture reflects the "way things are done" and is defined by the "shared values, common assumptions and patterns of belief held by organizational members" (Patterson et al., 2005:

380). On the other hand, the study of organizational climate developed from psychology and reflects how people "perceive" and "describe" their environment (Verbeke, Volgering, & Hessels, 1998). Organizational climate includes the employees' shared set of "perceptions of organizational policies, practices and procedures, and [their] patterns of interaction and behaviors" (Patterson et al., 2005: 381). Climate is often understood as a surface manifestation of culture, a "snapshot" (Schein, 1985), and therefore, tends to be measured quantitatively with surveys applied comparatively across several organizations. On the other hand culture is seen as the deeper level, often researched using qualitative methods on a single-firm basis (Schwartz & Davis, 1981). The current study, which compares quantitative data from many different organizations, examines climate rather than culture.

A representation of the overall climate of an organization would be broad and complex, having many different dimensions. Many measures attempting to evaluate an overall firm climate were criticized as unwieldy with vaguely defined dimensionality (Glick, 1985, 1988). Therefore, researchers have elected to assess sub-climates of organizational climate using variables related specifically to the dimension of interest, resulting in shorter and less-complex measures. There can be many types of organizational sub-climates. For example, academic research has explored the safety climate (Zohar, 1980), the service climate (Schneider & Bowen, 1985), and the innovation climate (Anderson & West, 1998). The current study explores the organizational ethical climate.

2. Theory and Measures of Ethical Climate

An ethical climate in an organization is defined as "the shared perceptions of what ethically correct behavior is and how ethical issues should be handled" (Victor & Cullen, 1987: 51-52). It reflects how members of an organization perceive and describe the moral intentions and consequences of firm policies, practices and procedures. Ethical climate

influences the perception of what is appropriate behavior in the firm. An ethical climate arises when members of a firm understand that certain types of behavior or decision-making processes are the norm within the firm (Cullen, Parboteeah, & Victor, 2003). Ethical climate can influence which issues members of an organization prioritize or consider to be ethically relevant. Moreover, ethical climate can influence the criteria that members use to understand, evaluate and resolve such issues (Cullen, Victor, & Stephens, 1989). The current study explores whether ethical climate influences how stakeholder groups are prioritized, expanding on the theoretical link made by Jones, Felps, & Bigley (2006) between ethical culture and stakeholder salience, as discussed above.

An early measure of ethical work climate, the Ethical Climate Questionnaire (ECQ) (Victor & Cullen, 1987, 1988), is grounded in Kohlberg's theory of cognitive moral development (Kohlberg, 1973, 1976). Kohlberg proposed that peoples' skill and judgment in resolving moral dilemmas develop as they mature through a specific sequence of levels of cognitive moral reasoning. He suggests that children begin at the "pre-conventional" level of moral judgment; that is, young children act from an egoistic motivation, to avoid punishment from authority figures, or to win praise or reciprocity. Older children and teens progress to the "conventional" or "benevolence" stage of making moral judgments; through their actions they seek peer acceptance by fulfilling expectations and following social norms/rules. Kohlberg finds that some adults (but not all) reach the "post-conventional" stage of the social contract or the principled conscience, where principles which underlie laws and rules, such as justice and human rights, are considered when evaluating actions. In developing the ECQ to evaluate ethical climate, Victor and Cullen (1987, 1988) raised Kohlberg's theory of moral development to a collective or social system level of analysis, determining the prevailing level of moral judgment within an organization.

A recent meta-analysis reviewed twenty years worth of empirical research using the ECQ (Martin & Cullen, 2006). Over 170 studies have used the ECQ to link ethical climate to a variety of outcomes and consequences. Most of these outcomes arise from organizational behavior literature, such as commitment, organizational citizenship and job satisfaction. Additionally, some studies have linked the ethical climate concept to negative or dysfunctional behavior such as lying, stealing, or falsifying reports. There are a few instances where an ethical climate has been linked to outcomes arising from broader management literature, such as performance (Jaramillo et al., 2006). One empirical study explored a link between ethical climate as measured by the ECQ and the stakeholder concept (Morris, 1997). The research question involved ethical climate as the consequence, rather than as the antecedent of stakeholder management. This was a survey-based study, not looking at the strengths or weaknesses of stakeholder management as in the current study, but whether the structural presence of stakeholder management devices (such as public affairs offices, employee newsletters, community projects) impacted firm ethical climate. Morris found that stakeholder management devices are strongly related to ethical climate in ways that are likely to impact employee ethical behavior (Morris, 1997, 422).

There have been some weaknesses identified with the ECQ measure of ethical climate. A theoretical drawback is that there is essentially only one construct being measured to assess the ethical climate—the collective level of moral judgment. It has been argued that the ECQ model is underspecified as this one construct is not sufficient to capture the entirety of an ethical climate (Arnaud & Schminke, 2006, 2007). One of the largest empirical issues concerns unstable factor structures and inconsistent configurations, with factor structures ranging from three (Wimbush, Shepard, & Markham, 1997) to eight (Fritzsche, 2000) or occasionally nine (Peterson, 2002b) emergent types of ethical climate. New research has attempted to improve

the ECQ model and its factor outcomes, for example, by adding additional dimensions (Lemmergaard & Lauridsen, 2008). But the ECQ cannot yet be considered a fully formally validated and psychometrically sound measure (Mayer, Kuenzi, & Greenbaum, 2009). Even after 20 years, the ECQ is still a work in progress.

3. The Ethical Climate Index (ECI)

Arnaud (2006) has recently introduced the Ethical Climate Index (ECI), a new construct and measure to evaluate the ethical work climate of organizations. Building upon Victor and Cullen's (1988) Ethical Climate Questionnaire (ECQ), Arnaud's ECI goes beyond a one-step moral judgment assessment and encompasses Rest's (1984, 1986) four-step ethical decision-making process at the social system level. Arnaud set out to develop a validated measure of ethical climate that would 1) improve the theory by including more distinct dimensions of an ethical decision-making process; 2) have more structural soundness to the construct, and 3) have improved predictability when it comes to ethical behaviors and attitudes.

In order to give greater depth to a measure of ethical climate, Arnaud (2006) and Arnaud and Schminke (2007) based their new ethical climate conception on Rest's ethical decision-making process. Realizing that good moral judgment is not sufficient to ensure an outcome of ethical action in a given situation, Rest (1984, 1986) asserts that ethical decision-making involves four essential psychological processes: 1) moral sensitivity to recognize the ethical issue and its impact on others, 2) moral judgment to determine which course of action would be most ethical, 3) moral motivation to ensure that ethical values (e.g. honesty or fairness) override other potential values in a given situation (i.e., economic or power values) and 4) moral character, or the acceptance of responsibility to commit to and implement an ethical planned course of action (Rest, 1984: 98, 1986).

To evaluate ethical work climate, Arnaud raised Rest's dimensions to the collective social system to evaluate at the organizational level, measuring: 1) collective moral sensitivity, consisting of moral awareness and empathetic concern; 2) collective moral judgment, which divides between focus on self and focus on others; 3) collective moral motivation; and 4) collective moral character (Arnaud, 2006). With this framework, Arnaud developed a 36-question survey instrument to assess ethical climate—The Ethical Climate Index. Arnaud conducted empirical tests of the Ethical Climate Index instrument using respondents based in the United States. Her results confirmed validity and reliability of the measure, and supported that raising individual perceptions of these dimensions to reflect a collective ethical work climate was appropriate. She found, furthermore, that each component was related to ethics-related outcomes, with correlations ranging from .25 to .48—considerably higher than the ECQ (Arnaud, 2006).

The current study will contribute to the literature outlined in this chapter by further developing the theoretical relationship between ethical climate and stakeholder management. This study uses the ECI instrument and its more highly specified conception of ethical climate for the exogenous variables (See the ECI questions in Appendix C). The four components of the ECI are described below, including a review of relevant literature. The discussion of each ethical climate component concludes with the development of the hypotheses related to how that component relates to strengths and weaknesses in stakeholder management.

a. Collective Moral Sensitivity

Moral sensitivity requires both the recognition of when an ethical issue exits, as well as an understanding of how one's actions are likely to affect others (Rest, 1984). Business people are sometimes "confronted with far more stimuli then they can fully comprehend and those stimuli are often ambiguous, complex, and even contradictory" (Finkelstein & Hambrick,

1996). In this environment, selective managerial attention becomes a necessary coping strategy for filtering information (Bazerman, 2001). Moral issues compete for attention with many other business issues but may be less likely to be overlooked when moral sensitivity is high (Butterfield, Trevino, & Weaver, 2000).

Raising the moral sensitivity of all employees is part of developing an ethical climate in an organization (Schminke, Arnaud, & Kuenzi, 2007). Training in moral sensitivity can socialize employees by signaling the expected modes of perception of ethics issues and the appropriate patterns of emotional response (Chinoy, 1961: 75). For example, Lockheed Martin requires all employees to take part in an annual Ethics Awareness training course where small groups discuss hypothetical scenarios involving ethical issues such as conflicts of interest, corrupt billing practices, falsification of records, bribery, work-life balance, and diversity concerns like age or sexual orientation (See (http://www.lockheedmartin.com/aboutus/ethics/2009-training/index.html) accessed 8/1/2009). Lockheed employees are taught to recognize ethical issues, and asked to think about the impact unethical behavior can have on stakeholders such as fellow employees, customers, suppliers, and the company as a whole. In this way Lockheed can socialize their workforce to pay attention to ethical issues that arise in day to day work experiences, and understand the broader implications of those issues on stakeholders, which will hopefully lead employees to resolve issues appropriately.

i. Development of Hypotheses Regarding Moral Awareness

The Ethical Climate Index measure breaks down the construct Collective Moral Sensitivity into two sub-components: "Moral Awareness" and "Empathetic Concern" (Arnaud, 2006). Norms for Moral Awareness at the social systemic level deal with such issues as whether people in the organization pay attention to ethical issues, and whether they

recognize quickly when a rule has been broken or when a moral dilemma arises. Moral awareness has been assessed in scholarly research on the individual level. The ECI is the first instrument to test the construct of moral awareness on the collective level. Arnaud (2006) builds upon the research on the individual level to develop her model.

Much of the prior research on moral awareness attempts to determine the antecedents of developing such sensitivity, both on an individual or situational basis. For example, research has explored individual antecedents such as gender (Ameen, Guffey, & McMillan, 1996; Fleishman & Valentine, 2003); national culture (Cherry, Lee, & Chien, 2003); age/experience (Singhapakdi, Rao, & Vitell, 1996; Sparks & Hunt, 1998); and values or orientation (Reynolds, 2006; Shaub, Finn, & Munter, 1993). The empirical research on individual antecedents to moral awareness is mixed, with factors such as age and gender not consistently providing much explanatory power, and factors like experience, values or orientation proving to be more robust (Tenbrunsel & Smith-Crowe, 2008).

Situational antecedents to moral awareness have proven to be even more robust antecedents to moral awareness, including issue intensity (Jones, 1991), and the ethical infrastructure in an organization. Particular aspects of issue intensity seem to be most important, specifically social consensus and the magnitude of consequences (Marshall & Dewe, 1997), as well as proximity and the concentration of effort (Dukerich, Waller, George, & Huber, 2000). Elements of the ethical infrastructure in an organization that appear to be important antecedents of moral awareness include codes of ethics (Weaver & Trevino, 1999) and professional or organizational socialization (Bebeau, Rest, & Yamoor, 1985; Sparks & Hunt, 1998). On the other hand, some aspects of an organization can lead to a lack of moral awareness, including frequent use of euphemistic language (Bandura, 1999) and previous incidents of unethical decisions (Tenbrunsel & Messick, 2004).

Empirical research has also found relationships between the existence of moral awareness and intention toward or enactment of ethical behavior. For example, moral awareness has been found to predict the intention to behave ethically (Cohen, Pant, & Sharp, 2001). Using the ECI, Arnaud (2006) specifically found that high moral awareness is related to lower levels of interpersonal deviance ($\beta = -.32$, $p<.05$).

This link between moral awareness and organizational ethical behavior should also hold true with regard to corporate social action toward stakeholders. Norms of high moral awareness within an organization would indicate that members are more likely to perceive and pay attention to ethical issues involving individuals with legitimate claims on the firm or those who can affect or are affected by firm activities—in other words, stakeholders (Hill & Jones, 1992). Where norms of high moral awareness prevail in a company, managers responsible for stakeholder relationships would also be likely to have internalized those norms. Such managers would perceive it to be appropriate to pay attention to broad stakeholder interests—in fact given those norms, they may not feel they have the discretion to filter out stakeholder interests, given that culture can act as a constraint on management discretion (Finkelstein & Boyd, 1998; Hambrick & Mason, 1984). Thus this aspect of the organizational climate could act as a constraint on the managers who deal with stakeholder relationships in a way that would limit managers from acting outside of these norms (Hambrick & Finkelstein, 1990; Phillips et al., 2007).

Empirical research has found that managers who perceive their organizations to be more ethical have higher perceived discretion with regard to intentions to act ethically (Key, 2002). Where a high level of moral awareness is the norm within the organization, then managers would also be more likely to be aware of the interests of stakeholder groups and act in an ethical manner towards stakeholders. Such firms would be more likely to have fewer

weaknesses in stakeholder relationships, and greater levels of strengths. Likewise, where moral awareness is not the norm within the organization, then managers would be likely to have internalized norms of low moral awareness and be more likely to filter out ethical issues related to stakeholder interests from the myriad of demands on their attention. As moral sensitivity is the first step in the decision-making process to engage in ethical behavior, the resulting strengths or weaknesses in behavior towards stakeholders is likely to be related to the existence or lack of collective moral sensitivity, in the form of the norms of moral awareness.

This leads to the first four hypotheses:

H1a. Moral Awareness will be negatively related to Institutional Weaknesses.

H1b. Moral Awareness will be negatively related to Technical Weaknesses.

H1c. Moral Awareness will be positively related to Technical Strengths.

H1d. Moral Awareness will be positively related to Institutional Strengths.

ii. Development of Hypotheses Regarding Empathetic Concern

As previously discussed, the Ethical Climate Index measure breaks down the construct Collective Moral Sensitivity into two sub-components: "Moral Awareness" and "Empathetic Concern" (Arnaud, 2006). ECI questions relating to norms for Empathetic Concern inquire as to whether people in their organization tend to pity or feel sorry for others who are treated unfairly, being taken advantage of or simply having difficulties. Empathetic concern has been assessed in scholarly research on the individual level. The ECI is the first instrument to test the construct of empathetic concern on the collective level. Arnaud (2006) builds upon the research on the individual level to develop her model.

Research has shown that situational antecedents can strongly predict empathetic concern, such as the ability to perceive another as in need, and the ability to adopt another's

perspective (Batson, 1991). Organizational attributes that encourage empathetic concern and perspective taking include high interaction and a high sense of production ownership (Parker & Axtell, 2001) as well as role orientation—such as a customer service role (Axtell, Parker, Holman, & Totterdell, 2007). Empathetic concern has been linked to ethical behavior such as helping and volunteering (Davis, Hall, & Meyer, 2003; Davis et al., 1999). Similarly, lack of empathy has been linked to unethical behavior, such as crime (Cohen & Strayer, 1996) and bullying (Ireland, 1999).

Empathetic Concern is measured in the ECI as the collective norm of the organization. Because this factor can be predicted by situational/organizational factors, and has been linked to ethical behavior on an individual level, thus, it follows that on a collective level, norms of empathetic concern could impact action on an organizational level. Arnaud (2006) specifically found that high levels of empathetic concern are related to lower levels of organizational political behavior ($\beta = -.48$, $p<.05$).

This link between high levels of empathetic concern and organizational ethical behavior, and low levels of empathetic concern and unethical behavior should also hold true with regard to corporate social action toward stakeholders. This is because managers responsible for maintaining stakeholder relationships would be likely to internalize the prevailing norms of ethical concern in the organization. Norms of empathetic concern in the organizational culture could act as a constraint on the managers who deal with stakeholder relationships in a way that would limit managers from acting outside of these norms (Hambrick & Finkelstein, 1990; Hambrick & Mason, 1984; Phillips et al., 2007). The managers would perceive a narrower range of appropriate behaviors within their discretion (Finkelstein & Boyd, 1998).

Empirical research has found that managers who perceive their organizations to be more ethical have higher perceived discretion with regard to intentions to act ethically (Key, 2002). In ethical climates with high norms of empathetic concern, a manager responsible for dealing with stakeholders would be more likely to have internalized those norms of caring and therefore care about legitimate stakeholder interests. She would also be more likely to feel she has discretion to initiate empathetic corporate social action toward stakeholders. In fact, in firms with norms of high empathy, an uncaring manager may feel constrained from engaging in stakeholder action that displays a lack of empathy or might harm stakeholder interests. On the other hand, where there are low norms of empathetic concern, a manager is less likely to be socialized to care about a broad array of stakeholder interests. Further, in a climate of low empathetic concern, a manager who does care about stakeholder interests may not feel she has latitude to initiate corporate social action which demonstrates empathy for broad stakeholder interests.

Thus levels of empathetic concern would relate positively with strengths in stakeholder relationships and negatively with weaknesses. In other words, firms with high empathetic concern would be more likely to have fewer weaknesses in stakeholder relationships, and greater levels of strengths. Likewise, where empathetic concern is not the norm within the organization, then managers would be free to disregard technical and institutional stakeholder relationships in favor of other organizational or even personal goals. This relationship would hold with both technical and institutional stakeholder categories, as empathetic concern could arguable extend to all types of stakeholder interests: employees, consumers, shareholders, communities, diversity and environmental concerns.

This leads to the following four hypotheses:

H2a. Empathetic Concern will be negatively related to Institutional Weaknesses.

H2b. Empathetic Concern will be negatively related to Technical Weaknesses.

H2c. Empathetic Concern will be positively related to Technical Strengths.

H2d. Empathetic Concern will be positively related to Institutional Strengths.

The first eight hypotheses are represented in the path diagram Figure 2.1.

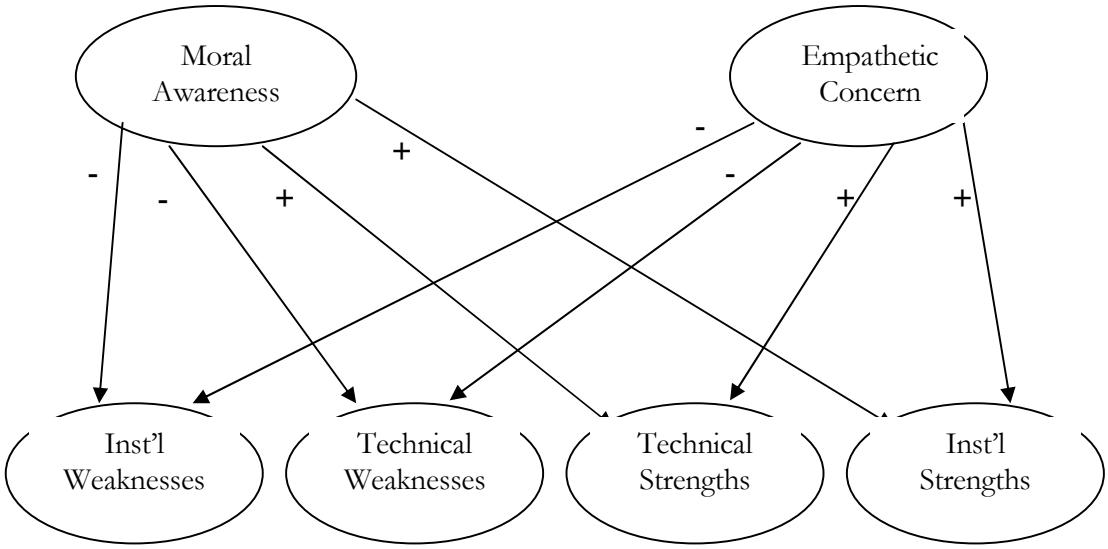

Figure 2.1: Path Diagram of Moral Sensitivity Hypotheses

b. Collective Moral Judgment

Once an ethical issue and its potential impacts have been identified, under Rest's four-step process a moral judgment must be made to determine the correct resolution of the issue (Rest, 1984). Rest's construct of moral judgment is based on Kohlberg's levels of moral development (Rest, Narvaez, Bebeau, & Thoma, 1999). Victor and Cullen's Ethical Climate

Questionnaire is also based on Kohlberg's theory, therefore, to assess Collective Moral Judgment in the ECI, Arnaud (2006) relies upon the items from the ECQ instrument that have the most consistent factor loadings. This resulted in two subscales: 1) "Focus on Self", which asks whether individuals in the organization mainly tend to look after their own interests, needs and benefits, and 2) "Focus on Others", which deals with minding the interests and welfare of others, the greater good and responsibility to society.

The classic example of an organizational climate that is focused on others is Johnson & Johnson with its corporate Credo. In its Credo, Johnson & Johnson lists the various stakeholder groups that it is responsible to, including first and foremost, their customers, but also employees, communities, the environment and finally, shareholders (see http://careers.jnj.com/careers/global/shared_values/our_credo, accessed August 1, 2009). Johnson & Johnson encourages consideration of its Credo in day to day business decision making. This climate ensures that moral judgments will be made in business decisions that are focused on others. Johnson & Johnson's ethical climate that emphasizes focus on others could be contrasted with the "Eat what you Kill" climate at many Wall Street finance institutions and law firms, where the focus on self is emphasized, as individuals are compensated in relation to the revenue they directly generate (Regan, 2005).

i. Development of Hypotheses Regarding Focus on Self

An ethical work climate with high levels of focus on self is characterized by norms of preconventional moral reasoning and low level cognitive moral decision-making, where action is determined by egoistic concerns like avoiding punishment and obtaining rewards. Findings from research using the Victor and Cullen model have found a positive correlation between low cognitive moral decision-making and unethical behavior (Trevino, Butterfield, & McCabe, 1998). Also, using the ECI, Arnaud (2006) specifically found that high focus on self is related

to higher levels of organizational political behavior (β = .16, $p<.05$). This link between collective moral judgment and organizational ethical behavior should also hold true with regard to corporate social action toward stakeholders, given the theoretical explanations provided by Jones et al. (2007).

The Collective Moral Judgment dimension of the ECI is similar to the typology of corporate stakeholder cultures described by Jones, Felps, & Bigley (2007). They propose that managerial behavior with regard to stakeholder relationships is influenced by the culture of the organization, a culture that can range on a continuum from a narrow self-interested culture to a culture based on broad concern for the interests of all stakeholders. The norms in the firm culture can provide guidance to managers to resolve tension in balancing competing claims of stakeholders. The propositions that Jones, Felps, & Bigley make suggest how broader or narrower stakeholder culture will influence managers to pay attention to broader or narrower stakeholder groups.

Jones, Felps, & Bigley's (2007) propositions can be adapted to the Collective Moral Judgment dimension of the ECI and Mattingly & Berman (2007) constructs of institutional versus technical strengths and weaknesses. Jones, Felps, & Bigley suggest that managers in stakeholder cultures with a high focus on self will be most interested in short-term shareholder wealth maximization. Thus, where high levels of focus on self are the norm within the organization, the managers would act in favor of the technical, resource-based groups, and not in favor of institutional, normative stakeholders. Such firms would have high strengths and low weaknesses with technical stakeholder relationships, but high weaknesses and low strengths in institutional stakeholder relationships.

This leads to the following hypotheses:

H3a. Focus on Self will be positively related to Institutional Weaknesses.

H3b. Focus on Self will be negatively related to Technical Weaknesses.

H3c. Focus on Self will be positively related to Technical Strengths.

H3d. Focus on Self will be negatively related to Institutional Strengths.

ii. Development of Hypotheses Regarding Focus on Others

An ethical work climate with a high level of focus on others is typically characterized by higher levels of cognitive moral decision-making, i.e. the conventional or post-conventional levels, from Kohlberg's (1981) theory of cognitive moral development, where actions are based on considerations of the accepted social norms, or principles of justice. Findings from research using the Victor and Cullen model have linked high cognitive moral decision-making to low levels of unethical behavior such as misuse of property, or production deviance (Peterson, 2002b). Arnaud (2006) specifically found that high levels of focus on others is related to lower levels of organizational political behavior ($\beta = -.22$, $p<.05$).

Again, based on the theoretical contribution of Jones, Felps, & Bigley (2007), this link between collective moral judgment and organizational ethical behavior should also hold true with regard to corporate social action toward stakeholders. Jones et al. (2007) suggest that where high levels of concern for others are the norm within the organization, managers would also be more likely to care about the interests of a broad range of stakeholder groups: in this study that would mean both the institutional groups where there is a normative basis for their legitimacy, as well as the technical stakeholder groups where there is a resource exchange relationship. Thus firms with a norm of high concern for others would have higher strengths and fewer weaknesses in all stakeholder relationships.

This leads to the next four hypotheses:

H4a. Focus on Others will be negatively related to Institutional Weaknesses.

H4b. Focus on Others will be negatively related to Technical Weaknesses.

H4c. Focus on Others will be positively related to Technical Strengths.

H4d. Focus on Others will be positively related to Institutional Strengths.

The second set of eight hypotheses is represented in the path diagram Figure 2.2.

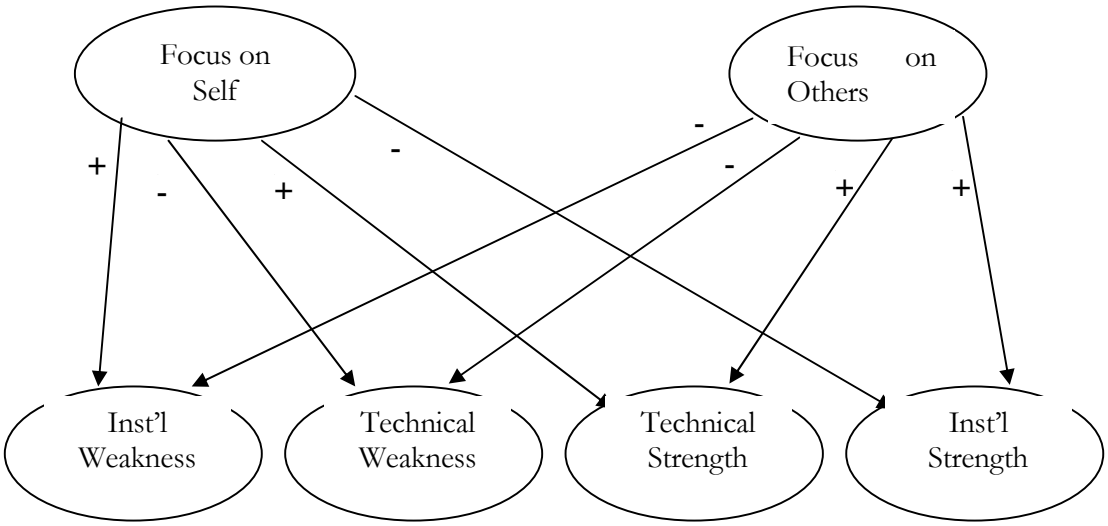

Figure 2.2: Path Diagram of Moral Judgment Hypotheses

c. Development of Hypotheses Regarding Collective Moral Motivation

Moral motivation forms the ethical intent to act in accordance with the ethical judgment made in the second step of the ethical decision-making process (Rest, 1986). One may assume that ethical action would follow ethical judgment unless one does not have the will to prioritize certain ethical values such as benevolence and universalism over other values such as power, wealth or achievement. Moral motivation assesses this will or intent. Arnaud (2006) operationalizes Collective Moral Motivation by exploring whether values such as

integrity, honesty and honor are generally prioritized as the prevalent values in the social system over other values such as personal advancement, power, or greed.

Most large firms have corporate value statements, but the question remains as to whether the values that appear on the firm website are truly incorporated in the social system of the firm climate. Whole Foods is one firm that not only lists its core values on its website, but explains in detail its goals and programs to maintain those values in its day to day business (see http://www.wholefoodsmarket.com/values/corevalues.php accessed August 1, 2009). For example, one value relating to employees is "Supporting Team Member Excellence and Happiness" and one goal under this value is for fairness and openness in compensation. As evidence, Whole Foods sets a salary cap for high earners at 19 x average employee compensation. Another value is "Caring About Communities and Environment" and lists a goal of supporting farmers and sustainable agriculture. To this end, Whole Foods details its local producer loan program, which helps local farmers to build their business and bring more local products to market. Whole Foods has received numerous awards for living its values; in 2009 alone it won the Socially Responsible Retailer Award for the work of its foundation, the Most Humane Grocery Store for its humane product labeling, as well as the Green Choice Award for its efforts supporting sustainable agriculture and alternative energy. It does not appear that at Whole Foods, values such as power, greed or personal attainment are prioritized in the corporate culture over values such as integrity, honor and fairness.

Values have been conceived in scholarly work not only on an individual level but also as organizational values systems (Liedtka, 1989). Organizational socialization can lead to an alignment between an employee's and an organization's values (Cable & Parsons, 2001). A great deal of empirical research has explored the connection between values and ethical behavior. For example, altruistic values such as justice and equality were found to have a

negative relationship with bribery, coercion, deception, theft and discrimination, while egoistic values have been found to have a positive relationship with such unethical behavior (Fritzsche & Oz, 2007). Understanding and tolerance have been linked with prosocial behavior such as helping (Gaerling, 1999). Using the ECI, Arnaud (2006) specifically found that high collective moral motivation is related to both higher levels of ethical behavior ($\beta = .34$, $p<.05$) and higher levels of organizational citizenship behavior, such as helping ($\beta = .46$, $p<.05$).

This link between collective moral motivation and organizational ethical behavior should also hold true with regard to corporate social action toward stakeholders. As discussed above, the prevailing ethical values of the organizational climate could become internalized norms for the managers who deal with stakeholder relationships in a way that would constrain managers from acting outside of these norms (Finkelstein & Boyd, 1998; Hambrick & Finkelstein, 1990; Hambrick & Mason, 1984; Key, 2002; Phillips et al., 2007). Where moral values such as honesty, fairness and honor are prioritized as the norm within the organization, over power, personal advancement and greed, then managers would also be bound by those norms and would be more likely to value honest, fair and honorable actions toward stakeholders to a greater extent. Such firms would be more likely to have fewer weaknesses in both technical and institutional stakeholder relationships, and greater levels of strengths. On the other hand where power, greed and personal advancement are the prevailing values in an organization, nothing in the ethical climate values would stop the manager from putting their own interests above stakeholder interests. Thus firms with low collective moral motivation would have more weaknesses in both technical and institutional stakeholder relationships, and fewer strengths.

This leads to the next four hypotheses and the path diagram in Figure 2.3.:

H5a. Collective Moral Motivation will be negatively related to Institutional Weaknesses.

H5b. Collective Moral Motivation will be negatively related to Technical Weaknesses.

H5c. Collective Moral Motivation will be positively related to Institutional Strengths.

H5d. Collective Moral Motivation will be positively related to Technical Strengths.

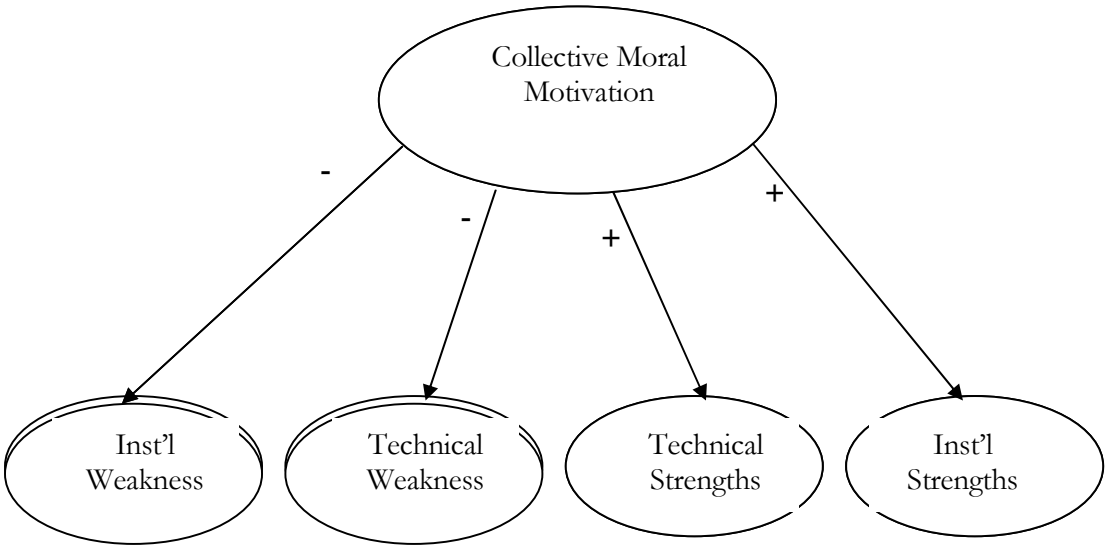

Figure 2.3: Path Diagram of Moral Motivation Hypotheses

d. Development of Hypotheses Regarding Collective Moral Character

Even if one identifies an ethical issue, makes an ethical judgment of the appropriate action to take, and develops the intention to act ethically, Rest's four-step process recognizes that actions do not always follow intentions (Rest, 1986). The final step in Rest's (1986) ethical decision-making framework is moral character, or having the courage and fortitude to take

responsibility, carry through and turn ethical intentions into ethical behavior. With her Collective Moral Character component, Arnaud (2006) assesses whether people in an organization tend to take charge when faced with a moral dilemma, feel responsible to do the right thing, and assume control for outcomes.

Organizational practices can build collective moral character. For example, as part of their compliance and integrity program, Kraft Foods has implemented a Speaking Up and Being Heard policy that encourages employees to ask questions and raise concerns about business practices when they see something that might be wrong (See http://www.kraftfoodscompany.com/About/compliance-integrity/Compliance-Integrity-program.aspx, accessed August 1, 2009). Employees may be more likely to have the courage to take responsibility and raise issues when they know they will be heard and when there will not be retaliation for reporting misconduct. In turn, Kraft has instigated a Listening, Investigating, Acting strategy for dealing with complaints so that employees know the issues they raise will be handled expediently and the appropriate consequences will result.

Arnaud bases the Collective Moral Character component of the ECI on research exploring moral character on an individual level as well as an organizational level (Arnaud, 2006). Moral character on the individual level has been tied to ethical behavior. For example, behaviors such as helping and volunteering are more likely to be undertaken by those with high personal norms for assuming responsibility (Schwartz & David, 1976; Zuckerman, Siegelbaum, & Williams, 1977). Some organizational characteristics have also been linked to higher likelihood of employees engaging in prosocial behaviors, such as a "virtuous circle" of reciprocal helping behaviors within an organization (Deckop, Cirka, & Andersson, 2003). Furthermore, organizational characteristics such as policies against wrong-doing and organizational responsiveness when wrongdoing is detected have been tied with higher levels

of whistle-blowing (Miceli & Near, 2002). Arnaud (2006) specifically found that high collective moral character is related to both higher levels of ethical behavior ($\beta = .26$, $p<.05$) and higher levels of ethics program follow-through ($\beta = .33$, $p<.05$). Additionally, high collective moral character was found to be related to higher levels of organizational citizenship behavior, such as helping ($\beta = .50$, $p<.05$).

This link between collective moral character and organizational ethical behavior should also hold true with regard to corporate social action toward stakeholders. Where the prevailing moral character of the organizational climate is to take responsibility and follow through with action, managers who deal with stakeholder relationships would internalize these norms and be socialized to carry through with social actions toward stakeholders. (Hambrick & Finkelstein, 1990; Hambrick & Mason, 1984; Key, 2002; Phillips et al., 2007). Indeed, where action and responsibility are the norm, the stakeholder manager would likely be constrained from shirking her responsibility for managing stakeholder relationships (Finkelstein & Boyd, 1998).

In the current study, where the norms related to organizational moral character are to take responsibility and carry through with ethical intentions, then managers would also be more empowered to take ethical actions toward stakeholders. Such firms would be more likely to have fewer weaknesses in stakeholder relationships, and greater levels of strengths. Where collective tendency does not promote taking responsibility, managers might be more likely to "pass the buck" when it comes to managing stakeholder concerns. In extreme situations, where those who do take responsibility face retaliation, managers may even be constrained from raising issues regarding stakeholder interests, leading to more weaknesses in stakeholder relationships and lower strengths.

This leads to the final four Hypotheses and the path diagram in Figure 2.4:

H6a. Collective Moral Character will be negatively related to Institutional Weaknesses.

H6b. Collective Moral Character will be negatively related to Technical Weaknesses.

H6c. Collective Moral Character will be positively related to Institutional Strengths.

H6d. Collective Moral Character will be positively related to Technical Strengths.

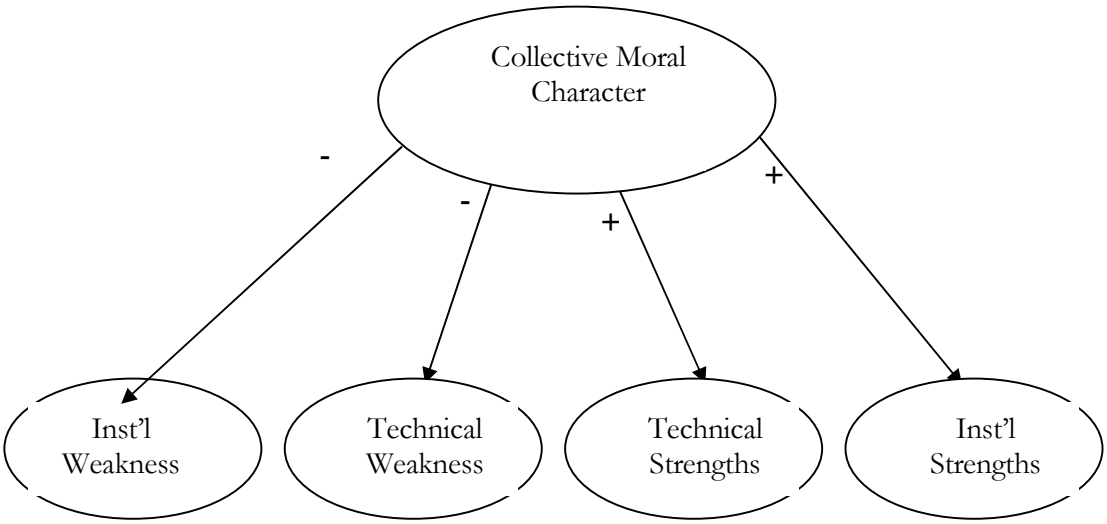

Figure 2.4: Path Diagram of Moral Character Hypotheses

D. Full Model and Summary of Research Hypotheses

In summary, this study draws on research on stakeholder management and ethical climate to test and extend the theoretical link between these two concepts, as proposed by Jones and colleagues (2007). The full model developed for this study is presented in Figure 2.5. In addition, a summary of all study hypotheses is presented in Table 2.1.

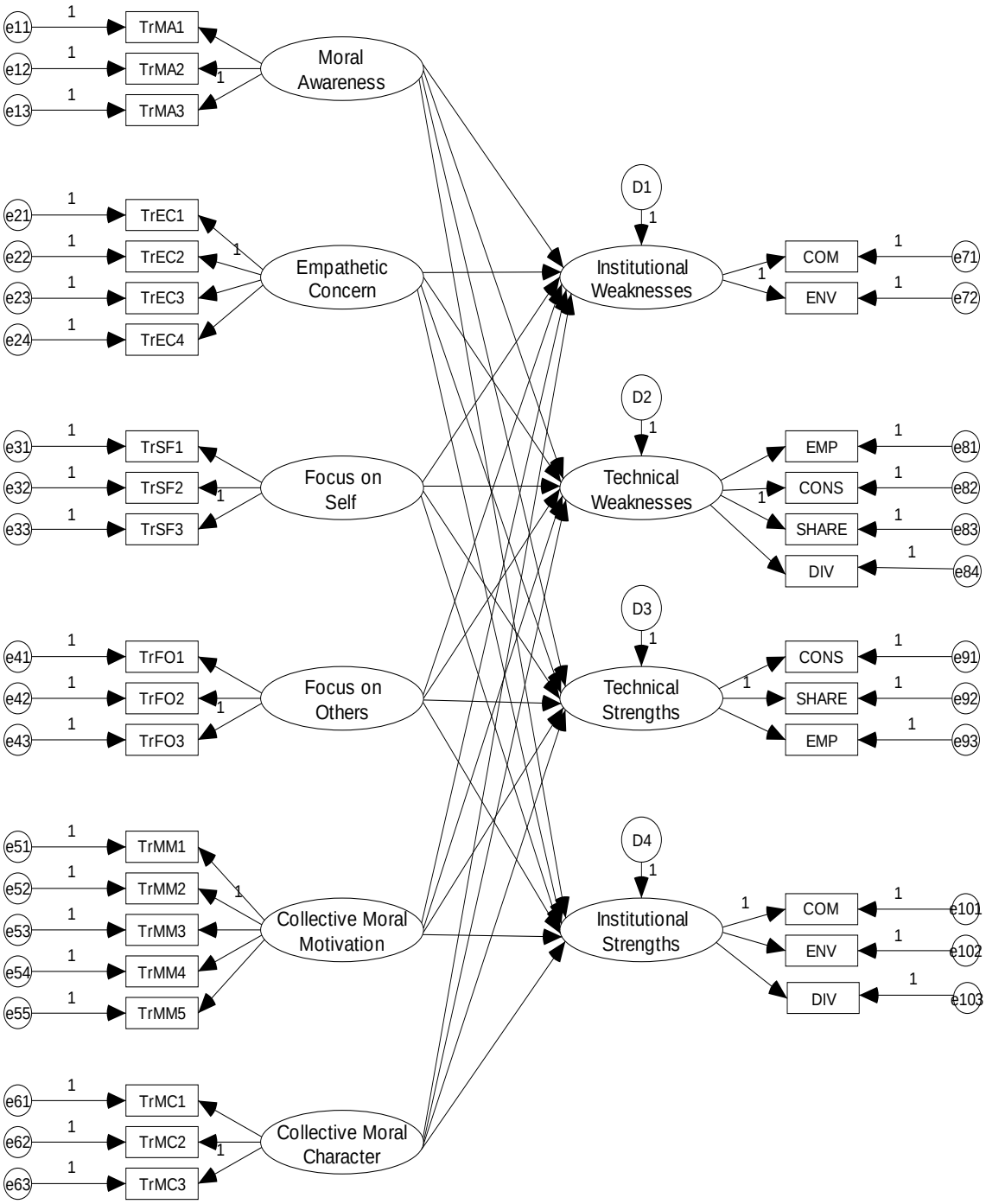

Figure 2.5: Full Model Path Diagram

Table 2.1: Summary of Hypotheses

HYPOTHESES
Moral Sensitivity
H1a. Moral Awareness will be negatively related to Institutional Weaknesses.
H1b. Moral Awareness will be negatively related to Technical Weaknesses.
H1c. Moral Awareness will be positively related to Technical Strengths.
H1d. Moral Awareness will be positively related to Institutional Strengths.
H2a. Empathetic Concern will be negatively related to Institutional Weaknesses.
H2b. Empathetic Concern will be negatively related to Technical Weaknesses.
H2c. Empathetic Concern will be positively related to Technical Strengths.
H2d. Empathetic Concern will be positively related to Institutional Strengths**.**
Moral Judgment
H3a. Focus on Self will be positively related to Institutional Weaknesses.
H3b. Focus on Self will be negatively related to Technical Weaknesses.
H3c. Focus on Self will be positively related to Technical Strengths.
H3d. Focus on Self will be negatively related to Institutional Strengths.
H4a. Focus on Others will be negatively related to Institutional Weaknesses.
H4b. Focus on Others will be negatively related to Technical Weaknesses.
H4c. Focus on Others will be positively related to Technical Strengths.
H4d. Focus on Others will be positively related to Institutional Strengths.

Table 2.1 (Cont'd): Summary of Hypotheses

Collective Moral Motivation
H5a. Collective Moral Motivation will be negatively related to Institutional Weaknesses.
H5b. Collective Moral Motivation will be negatively related to Technical Weaknesses.
H5c. Collective Moral Motivation will be positively related to Institutional Strengths.
H5d. Collective Moral Motivation will be positively related to Technical Strengths.
Collective Moral Character
H6a. Collective Moral Character will be negatively related to Institutional Weaknesses.
H6b. Collective Moral Character will be negatively related to Technical Weaknesses.
H6c. Collective Moral Character will be positively related to Institutional Strengths.
H6d. Collective Moral Character will be positively related to Technical Strengths.

Chapter 3: Methods and Analysis

A. Data

1. Ethical Climate Index.

a. Data Source. An existing data source was used for the exogenous variables of the present study using the Ethical Climate Index measure. The data was gathered by the Corporate Executive Board's Compliance and Ethics Leadership Council (CELC) for their 2007 study "Preempting Compliance Failures: Identifying the Leading Indicators of Misconduct." The population for the CELC data set was employees working in companies with 5000+ employees located in Australia, Canada, India, the United Kingdom and the United States. The number of respondents in the total data set was 1,752. For the present study, a subset of the CELC data was used reflecting only those respondents from companies which match with KLD company-level data for the dependent variables. The number of this subset is 376 respondents, who were employed by 195 KLD-covered companies. For most companies, there was one respondent. For 31 companies there was more than one respondent, with the actual number of respondents per company ranging from one to 16.

The survey to gather this data was conducted for CELC over the internet between February 15 and February 21, 2007 by a commercial data-gathering organization, Global Market Insite (GMI) (see Appendix E for information on GMI and its methodology). GMI sent the survey link to panelists recruited for this project from its specialty IT panel, Techsay, and its large company panel. The incentive for completing the survey was $10. Further information on how GMI recruits its panels is attached in Appendix E. The internet survey had a forced completion requirement that did not permit the skipping of questions; thus there are no missing data in any submitted responses. The survey instrument consisted of 90

questions, including the short form of the Ethical Climate Index, a measure of the firm ethics and compliance training program, a measure of observed or reported work misconduct, a measure of job satisfaction, a measure of organizational commitment, a measure of ethical pressure, as well as characteristics of the organization (industry, size), and demographic information including gender age, education, function, level of employment, compensation and years of experience. A copy of the Ethical Climate Index is attached in Appendix C.

b. Data Screening. To make the ECI data usable for the present study, three steps were taken: first, to ensure the data is clean, two instances of flat-liners (where the same answer was marked for each question) were eliminated. Second, examination for outliers identified one case for exclusion. These steps resulted in 373 respondents. Third, the data was aggregated per company. As with the Victor & Cullen ECQ (1987, 1988), aggregate scores of individual perceptions of ethical climate were indicators of the collective ethical climate. Before aggregating multiple scores into a company score, the statistical adequacy of aggregation by company was examined using the r_{wg} statistic. The r_{wg} statistic measures the degree to which individual ratings for a company are interchangeable, with mean rwg values of .70 or greater providing evidence of acceptable agreement among member responses on a scale (Bliese, 2000; Colquitt, 2001; George, 1990; George & James, 1993). Where the r_{wg} scores satisfied this requirement, the individual responses were aggregated to derive the company score for 31 firms. In 163 cases there was only one respondent per company. In such cases, the individual score was used as a psychological perception of corporate ethical climate, as has been done previously using the ECQ (Flannery & May, 2000; Peterson, 2002a, b; Trevino et al., 1998).) These procedures resulted in ECI scores for 194 companies.

The means, standard deviations, skewness, and kurtosis values for the Ethical Climate items are displayed in Table 3.1. The distribution of each item was skewed, many of them

significantly. There are two ways of assessing significant skewness: 1) values over 2 x the standard error of skewness would be considered significantly skewed, (in this case skewness values greater than the absolute value of .34); or 2) because the former way of assessing skewness is dependent on sample size, a more general way of assessing skew is to consider skew values above the absolute value of .8 to be significantly skewed.

Table 3.1: Descriptive Statistics for Ethics Climate Items (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Moral awareness				
MA1	4.71	.90	-1.02	1.94
MA2	4.51	.90	-.94	2.13
MA3	4.59	.98	-.78	1.26
Empathetic concern				
EC1	4.42	1.09	-.85	1.12
EC2	4.60	.91	-.98	2.46
EC3	4.59	.98	-.97	1.80
EC4	4.56	.98	-.97	1.95

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

Table 3.1 (cont'd): Descriptive Statistics for Ethics Climate Items (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Focus on self				
SF1	3.47	1.35	.16	-.70
SF2	3.86	1.24	-.32	-.22
SF3	3.73	1.29	-.21	-.38
Focus on others				
FO1	4.26	1.00	-.73	1.54
FO2	4.27	1.04	-.77	.80
FO3	4.35	1.06	-.92	1.44
Collective moral motivation				
MM1	3.30	1.31	.39	-.52
MM2	3.27	1.40	.31	-.81
MM3	3.23	1.50	.39	-.87
MM4	3.21	1.45	.27	-.85
MM5	3.04	1.42	.39	-.72
Collective moral character				
MC1	4.05	1.05	-.53	.58
MC2	4.42	1.10	-1.17	1.80
MC3	4.40	.97	-1.05	2.21

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

Because the distribution of each ECI item was skewed, a square root transformation was used to correct for skewness (as recommended by Judd & McClelland, 1989). Where the distribution was negatively skewed, the first step was to reflect it so that it becomes positively skewed, by subtracting all of the values for the variable from one plus the absolute value of maximum value for the variable (Weinberg & Abramowitz, 2008). This results in a positively skewed distribution with all values larger than zero. After the square root transformation, the distributions that had been negatively skewed were reflected once again to maintain the directionality of the relationships. The means, standard deviations, skewness, and kurtosis values for the transformed Ethical Climate Index subscales are shown in Table 3.2. Although one subscale (TrMC2) was still skewed according to the stricter standard based on standard error of skewness (values greater than the absolute value of .34), all of the variables are below the general standard of significant skewness (values greater than the absolute value of .8).

Table 3.2: Descriptive Statistics for Transformed Ethics Climate Items (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Moral awareness				
TrMA1	1.52	.31	.23	2.39
TrMA2	1.45	.28	-.20	.80
TrMA3	1.44	.30	-.12	.30

Note. Standard error for skewness was .17; standard error for kurtosis was .35

Table 3.2(cont'd): Descriptive Statistics for Transformed Ethics Climate Items (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Empathetic concern				
TrEC1	1.44	.31	-.20	.16
TrEC2	1.48	.29	-.17	.77
TrEC3	1.48	.31	-.27	.35
TrEC4	1.47	.31	-.23	.49
Focus on Self				
TrSF1	1.82	.38	.31	-.39
TrSF2	1.26	.36	.21	-.19
TrSF3	1.22	.37	.32	-.22
Focus on others				
TrFO1	1.38	.31	.01	.72
TrFO2	1.38	.31	-.18	.27
TrFO3	1.40	.32	-.21	.41
Collective moral motivation				
TrMM1	1.78	.37	-.07	-.42
TrMM2	1.76	.40	-.09	-.71
TrMM3	1.74	.43	.02	-.85
TrMM4	1.74	.42	-.12	-.81
TrMM5	1.69	.42	.02	-.85
Collective moral character				
TrMC1	1.31	.31	.08	.32
TrMC2	1.43	.33	-.50	.68
TrMC3	1.42	.29	-.31	.97

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

2. Stakeholder Management

a. Data Source. For the dependent variables reflecting stakeholder management, the KLD STATS database for year 2007 was used. KLD Research & Analytics, Inc. is the social investment research firm founded by Kinder, Lydenburg and Domini. KLD conducts research for investors on the social governance and environmental performance of the largest 3000 US companies by market capitalization. SOCRATES is the commercial database of corporate ratings, through which KLD provides narrative accounts and ratings on over 90 indicators in seven major areas including Community, Corporate Governance, Diversity, Employee Relations, Environment, Human Rights and Product. KLD ratings are based on five sources: 1) direct communication with companies; 2) global research firms; 3) media; 4) public documents; and 5) government and NGO information. KLD staff conducts daily reviews of covered companies, and updates are posted monthly. Appendix A contains information from KLD regarding its SOCRATES database, including how information is gathered and assessed.

KLD STATS (Statistical Tool for Analyzing Trends in Social and Environmental Performance) is the data set most often used for academic empirical research. It is a data set containing an annual snap-shot of all company ratings within the SOCRATES database at calendar year end. Appendix B contains information from KLD regarding its STATS data set.

b. Data Screening. To make the KLD data usable for this study, the following steps were taken. First, the individual criteria for each of the six stakeholder groups were summed into strengths and weaknesses, resulting in 12 indicators representing the social strength and weaknesses toward each stakeholder group. The means, standard deviations, skewness, and kurtosis values for the KLD subscales (raw data) were calculated (see Table 3.3). The distribution of each subscale was skewed.

Table 3.3: Descriptive Statistics for KLD (Raw Data) Subscales (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Community				
Strengths	.62	1.05	1.97	3.54
Weaknesses	.30	.57	1.92	3.48
Shareholders				
Strengths	.34	.64	2.05	4.16
Weaknesses	.98	.89	.82	.30
Diversity				
Strengths	1.86	1.77	.78	-.32
Weaknesses	.42	.56	.93	-.14
Employee relations				
Strengths	.67	1.00	1.47	2.62
Weaknesses	.95	.95	.81	.08
Environment				
Strengths	.51	1.04	2.09	3.48
Weaknesses	.51	1.10	2.42	5.55
Consumers				
Strengths	14	.39	2.79	7.54
Weaknesses	.85	.97	.85	-.39

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

The literature suggests standardizing the KLD subscales (Mattingly & Berman, 2006). The skewness and kurtosis values for the standardized KLD subscales are shown in Table 3.4. The findings indicate that the distributions of these standardized subscales were highly skewed, in some cases far more than the raw data.

Table 3.4: Descriptive Statistics for KLD (Standardized Data) Subscales (N = 194)

Item	Skewness	Kurtosis
Community		
Strengths	6.51	62.45
Weaknesses	1.92	3.48
Shareholders		
Strengths	2.05	4.16
Weaknesses	.82	.30
Diversity		
Strengths	.78	-.32
Weaknesses	.93	-.14
Employee relations		
Strengths	1.67	2.62
Weaknesses	.81	.08
Environment		
Strengths	2.09	3.48
Weaknesses	2.42	5.50
Consumers		
Strengths	2.79	7.54
Weaknesses	.85	-.39

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

Rather than standardize the data, a square root transformation was used to correct the raw data for skewness (as recommended by Judd & McClelland, 1989). The means, standard deviations, skewness, and kurtosis values for the transformed KLD subscales are shown in Table 3.5. Although some of the subscales were still skewed beyond the general standard of $|.80|$, most of the variables were remarkably less skewed. Given that the transformed variables were the least skewed, these transformed variables were used in succeeding (i.e., SEM and regression) analyses.

Table 3.5: Descriptive Statistics for KLD (Transformed Data) Subscales (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Community				
Strengths	.44	.64	1.02	-.37
Weaknesses	.27	.48	1.33	.07
Shareholders				
Strengths	.29	.51	1.29	.05
Weaknesses	.80	.59	-.28	-1.20
Diversity				
Strengths	.61	.51	.37	-.97
Weaknesses	.17	.22	.74	-.87
Employee relations				
Strengths	.50	.65	.76	-.92
Weaknesses	.74	.63	-.08	-1.47

Note. Standard error for skewness was .17; standard error for kurtosis was .35.

Table 3.5 (cont'd): Descriptive Statistics for KLD (Transformed Data) Subscales (N = 194)

Item	Mean	SD	Skewness	Kurtosis
Environment				
Strengths	.35	.63	1.45	.54
Weaknesses	.34	.63	1.57	1.04
Consumers				
Strengths	.14	.36	2.33	3.74
Weaknesses	.65	.65	.20	-1.59

Note. Standard error for skewness was .17; standard error for kurtosis was .35

Thus for both the Exogenous Ethical Climate Index data and the endogenous KLD Stakeholder Management data, the square root transformation variables were the least skewed and were used in subsequent analysis.

B. Structural Equation Model

Structural equation modeling techniques are distinguished from other statistical techniques by two characteristics: "1) estimation of multiple and interrelated dependence relationships, and 2) the ability to represent unobserved concepts in these relationships and account for measurement error in the estimation process" (Hair, Anderson, Tatham, & Black, 1998: 584). Hair and colleagues (1998) suggest that there are seven stages in building and testing a structural equation model:

1. A causal relationship between two or more variables must be defined, based on theory. The theoretical basis for the model in this study was detailed above in Chapter 2.

2. A path diagram of the predictive relationships among the constructs should be constructed. While all causal relationships should be indicated, the objective is to model the relationships among the constructs with the smallest number of correlations that can be justified by theory. The relationships are assumed to be linear. See Figure 2.5 for the path diagram of the current study.

3. The path diagram is converted into a series of structural and measurement models. In SEM with latent variables, the measurement models are first specified using confirmatory factor analysis (CFA) to determine whether the modeled relationships between the latent constructs and their respective indicator variables provide a good fit, and assess the reliability and validity of the constructs. The results of the measurement model tests are discussed below in Chapters 4 & 5. All analyses were conducted using the Statistical Package for the Social Sciences (SPSS) and Analysis of Moment Structures software (AMOS).

4. The estimation procedure is done. The Maximum Likelihood (ML) estimation procedure is the most common. In the ML procedure, the minimum sample size is 100 to 150, with a recommended sample size of 200. (A higher sample size might be indicated by a more complex model, however if sample size exceeds 400, the ML procedure "becomes 'too sensitive' and . . . all goodness-of-fit measures will indicate poor fit" (Hair et al., 1998: 605)). The most common process of estimation is direct estimation, where the parameter estimate and confidence interval are estimated in one step. The N for the data used in this study is 194, slightly less than the recommended sample size. Given the complexity of the structural model, a larger sample size would be desirable; however, the data should be sufficient for the exploratory nature of this study.

5. Once the structural equation model is estimated, then identification of the structural model must be assessed. There are two conditions for identification 1) the model's degrees of freedom must be zero or higher, and 2) each parameter must be uniquely estimated.

6. Several criteria are evaluated to assess the goodness-of-fit. The normed chi-square value will test the overall model goodness-of-fit Chi-square/df values less than 3 indicate good model fit (Schumacker & Lomax, 2004. AGFI, CFI and NFI values greater than .90 indicate good model fit (Hu & Bentler, 1999). RMSEA values less than .06 indicate good fit (Hu & Bentler, 1999), values between .06 to .08 indicate fair fit, while values ranging from .08 to .10 indicate mediocre fit and those greater than .10 indicate poor fit (Byrne, 2001). The results of the structural model tests are discussed below in Chapters 4& 5.

7. The final step is to interpret the model to determine its support of the underlying theory. If necessary, the model can be re-specified and estimated again once parameters are added or deleted to improve the model's support of theory. The results of the hypotheses tests are discussed below in Chapters 4 & 5.

Chapter 4: Results

A. Measurement Model Evaluation.

As discussed above, the fit of a structural equation model is assessed in two stages. First the validity and reliability of the measurement models are assessed in order to ensure the quality of the underlying model constructs prior to hypotheses testing. Second, the structural model is estimated, assessed and interpreted to determine whether the hypothesized paths are supported by the data. I will first discuss the results of the tests of the ethical climate measurement model, then the stakeholder management measurement model, before moving on to the structural model and hypotheses testing.

1. Ethical Climate Index Measurement Model. A confirmatory factor analysis was done to assess the measurement model of the Ethical Climate Index including the six subscales represented by latent variables and the 21 manifest indicator variables. CFA requires that one regression weight linking the observed indicators to the latent factor be assigned a value of 1.0; the other regression weights are then calculated relative to the assigned weight. Convention dictates that the indicator variable having the highest loading weight in either the literature or the exploratory procedure is assigned the arbitrary value of 1.0. This convention was followed.

According to SEM convention, several tests of significance were utilized to make decisions as to the construct of latent factors within the model, i.e. which variables "fit," or fail to fit, the hypothesized model, and whether certain variances or variables are correlated. The results of these tests are found in Tables 4.1 and 4.2 below.

The first of these tests is the statistical significance of the parameter estimates. For each measured or observed variable, the p value for significance should be less than .05 (i.e., $p < .05$). All the indicator variables met this level of significance.

Table 4.1: Maximum Likelihood Estimates for Indicator Variables

Path	B	S.E.	Beta	C.R.	Sig.
Moral awareness to:					
MA1	.80	.08	.68	10.14	.000
MA2	.92	.07	.86	13.88	.000
MA3	1.00		.87		
Empathetic concern to:					
EC1	1.14	.07	.86	16.84	.000
EC2	1.00		.89		
EC3	1.12	.06	.92	19.73	.000
EC4	1.08	.06	.89	18.14	.000
Focus on self to:					
SF1	.97	.05	.89	20.54	.000
SF2	.97	.04	.93	24.23	.000
SF3	1.00		.94		
Focus on others to:					
FO1	.67	.07	.64	9.98	.000
FO2	.92	.05	.88	17.65	.000
FO3	1.00		.92		

Table 4.1 (Cont'd): Maximum Likelihood Estimates for Indicator Variables

Path	B	S.E.	Beta	C.R.	Sig.
Collective moral motivation					
MM1	.79	.04	.88	21.71	.000
MM2	.92	.03	.94	29.51	.000
MM3	1.00		.96		
MM4	.96	.03	.94	29.23	.000
MM5	.91	.04	.89	22.92	.000
Collective moral character					
MC1	.69	.09	.61	10.49	.000
MC2	1.00		.84		
MC3	.76	.08	.71	9.74	.000

Also, the standardized regression weights linking indicator variables to latent variables should be greater than or equal to .70. In this study, some of the indicator variables did not meet this level. Specifically, the Beta for the link from variable MA1 to Moral Awareness was .68; the beta for the link from variable FO1 to Focus on Others was .64; and the beta for the link from variable MC1 to Collective Moral Character was .61. Some research suggests that indicator loadings of .6 may be acceptable (Bagozzi & Yi, 1988). Further, the calculation procedures underlying ML-SEM perform better (i.e., greater accuracy) where there are more than two items per construct (Bollen, 1989). Thus keeping an indicator with a low loading is thus likely to improve model predictiveness, assuming that the indicator does not load higher on any other latent variable in the model. This is not the case with any of the indicators with

loadings below .70, and as all loadings were above .60, therefore, it was determined to keep all the indicators in the model.

The reliabilities for each of the Ethical Climate subscales are presented in Table 4.2. A general guideline for Cronbach's alpha is that indicator loadings greater than .70 indicate acceptable internal consistency. The coefficient alphas for all latent variables ranged from acceptable ($\alpha = .76$) to very high ($\alpha = .97$).

Table 4.2: Internal Coefficient Alphas for Ethical Climate Subscales *(N = 194)*

Subscale	Item N	Alpha
Moral awareness	3	.84
Empathetic concern	4	.94
Focus on self	3	.94
Focus on others	3	.84
Collective moral motivation	5	.97
Collective moral character	3	.76

Furthermore, the standardized factor loadings of the Ethical Climate items and the correlations between the Ethical Climate factors are illustrated in Figure 4.1. Not all the constructs, however, were statistically significantly correlated with each other (as is shown in Table 4.3). Moreover, some of the constructs were highly correlated with each other (i.e., Moral Motivation and Focus on Self; Moral Awareness and Empathetic Concern; Empathetic Concern and Focus on Others; Focus on Others and Collective Moral Character), thus suggesting that these constructs did not uniquely explain the variance.

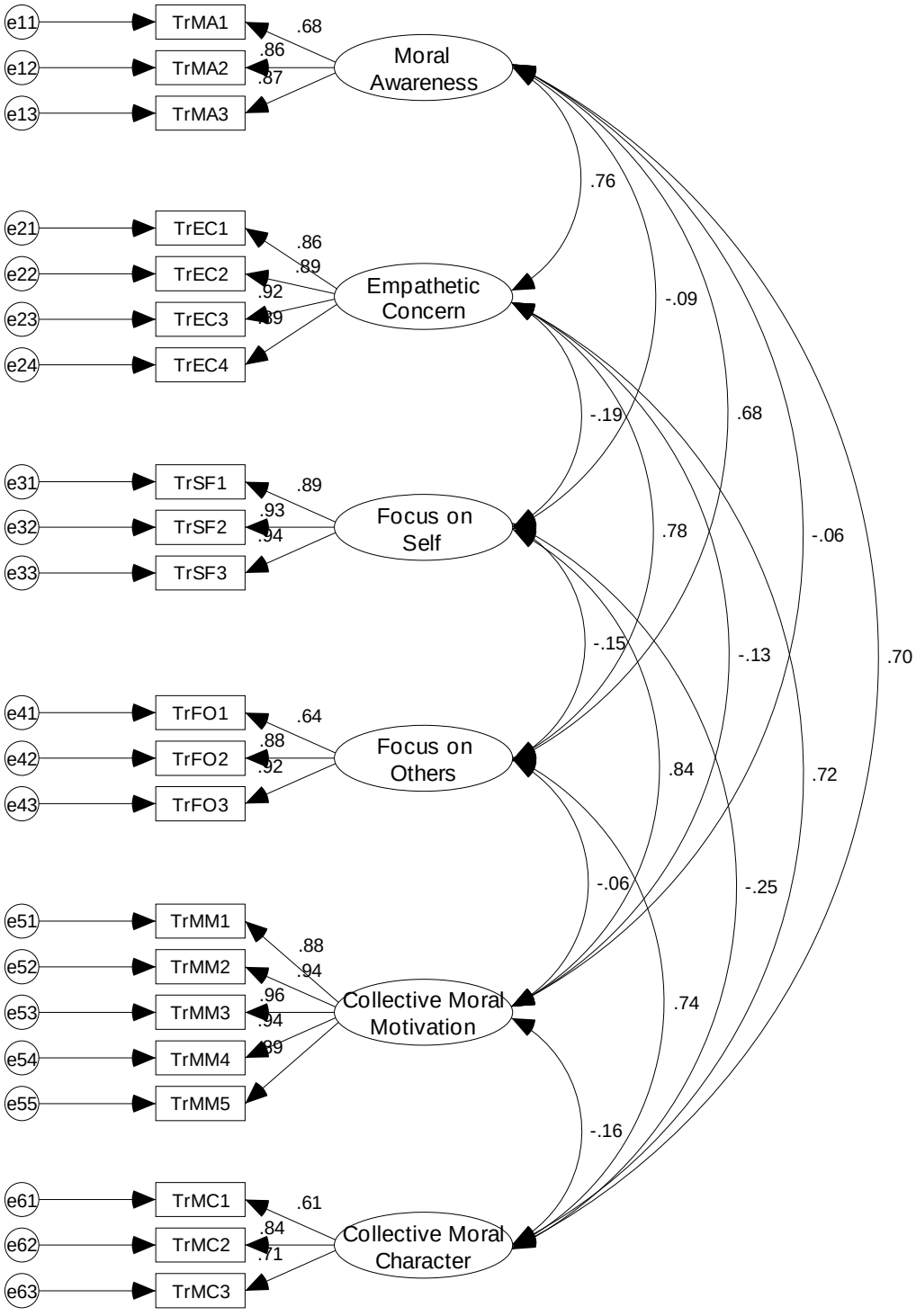

Figure 4.1: Confirmatory factor analysis results for ethical climate (items).

Table 4.3: Correlations between Constructs

Construct	MA	EC	FS	FO	MM
Moral awareness (MA)					
Empathetic concern(EC)	.76 ***				
Focus on self (FS)	-.09	-.19 **			
Focus on others (FO)	.68 ***	.78 ***	-.15 *		
Moral motivation (MM)	-.06	-.13	.84 ***	-.06	
Moral character (MC)	.70 ***	.72 ***	-.25 **	.74 ***	-.16

* $p < .05$. ** $p < .01$. *** $p < .001$.

After these criteria are satisfied, AMOS provides a series of indices of goodness-of-fit to assist researchers in assessing the overall measurement model. Fit indexes assess how close the data fit the measurement and structural models. The chi-square value (CMIN) should NOT be significant nor large. However since the chi-square value is sensitive to sample size, the chi-square test may be misleading and goodness of fit may be better examined through other tests (Kline, 2005). Several tests have been developed to attempt to remedy the x^2 problem of over-sensitivity to sample size and it is recommended to use multiple criteria to assess a model (Byrne, 2001). These alternative tests generally work by comparing the hypothesized (or "default") model to more or less restricted models. The models to which they are compared could be seen on a continuum, with the saturated model on one end (with the minimum number of constraints and therefore maximum fit) and the independence model on the other extreme (with the maximum number of constraints and minimum fit) (Blunch, 2008).

The following tests provided model fit data for this study: CMIN/df, AGFI, CFI, NFI and RMSEA.

CMIN/df. The ratio of chi-square values over the degrees of freedom (CMIN/df) was one of the earliest criteria designed to be less sensitive than the x^2 sample size. It could be said to be a normalization of x^2 (Blunch, 2008). Where this ratio value is less than 3, it indicates good model fit (Schumacker & Lomax, 2004).

AGFI. The adjusted goodness-of-fit model (AGFI) is classified as an absolute index because it essentially compares the hypothesized model with no model at all, adjusting the result for the number of parameters and degrees of freedom (Hu & Bentler, 1995). AGFI values range from zero to 1.00; the closer values are to 1.00 the better the fit, and generally values at or above .90 are seen to indicate good fit (Byrne, 2001).

NFI. The normed fit index (NFI) compares the hypothesized model to the independence model, rescaling the x^2 into a zero to 1.00 range, with 1.00 indicating perfect fit (Byrne, 2001). Models with NFI values at or above .90 are deemed acceptable.

CFI. Like the NFI, the comparative fit index (CFI) compares the existing model fit with a null model hypothesizing no fit (the independence model), but it also takes degrees of freedom into consideration (Blunch, 2008). CFI was chosen because of its resistance to the effects of sample size. In general, CFI should be equal to or greater than .90 for the model to be accepted (Hu & Bentler, 1999).

RMSEA. Root-mean square error of approximation (RMSEA) was chosen because it does not require a null model for comparison. This provided a strong comparison with the CFI and NFI. The RMSEA could be said to be a "badness of fit" criteria, with lower scores reflecting better fit. RMSEA values less than .06 indicate very good fit (Hu & Bentler, 1999), values between .06 to .08 indicate fair fit, while values ranging from .08 to .10 indicate

mediocre fit and those greater than .10 indicate poor fit (Byrne, 2001). Currently RMSEA is widely seen as the most informative criteria (Byrne, 2001) and therefore often used as the main measure of model fit (Blunch, 2008).

With all values except AGFI in the acceptable to good range according to the criteria, the ethical climate index measurement model fit the data well, as is shown in Table 4.4 below.

Table 4.4: Chi-square Results and Goodness of Fit Indices for Ethical Climate Model

Index	Value	Criteria
Chi-square	371.80	
Degrees of freedom	174	
Sig.	.00	
Chi-square/df	2.14	< 3.00
Adjusted goodness of fit index (AGFI)	.80	≥ .90
Normed fit index (NFI)	.91	≥ .90
Comparative fit index (CFI)	.95	≥ .90
Root mean squared error (RMSEA)	.077	≤ .10

2. Stakeholder Management Measurement Model Tests.

A confirmatory factor analysis was done to assess the proposed measurement model of the Stakeholder Management measurement model including the four sub-scales represented by latent variables and the 12 manifest indicator variables. As with the CFA for the Ethical Climate Index, the convention was followed of assigning one regression weight linking the observed indicators to each latent factor be assigned a valued of 1.0; the other regressions weights were then calculated relative to the assigned weight.

Again, according to SEM convention, several tests of significance were utilized to make decisions as to the construct of latent factors within the model, i.e. which variables fit, or fail to fit, the hypothesized model, and whether certain variances or variables are correlated. Table 4.5 shows the results of this test. The first of these tests is the statistical significance of the parameter estimates. For each measured or observed variable, the p value for significance should be less than .05 (i.e., $p < .05$). All the indicator variables except Diversity Weaknesses (CR=.58; $p = .56$) met this level of significance.

Table 4.5: ML Estimates for Indicator Variables (Proposed four-factor KLD Model)

Path	B	S.E.	Beta	C.R.	Sig.
Institutional Weaknesses to					
Community	1.00		.50		
Environment	1.99	.36	.74	5.45	***
Technical Weaknesses to					
Employees	1.00		.34		
Consumers	1.37	.41	.45	3.34	***
Shareholders	1.66	.45	.61	3.65	***
Diversity	.05	.09	.05	.58	.562
Technical Strengths to					
Consumers	1.00		.41		
Shareholders	2.33	.44	.67	5.24	***
Employees	2.87	.55	.65	5.17	***
Institutional strengths					
Community	1.00		.65		
Diversity	.88	.11	.71	7.98	***
Environment	1.05	.13	.69	7.85	***

Second, the standardized regression weights linking indicator variables to latent variables should be greater than or equal to .70. Figure 4.2 illustrates the results of this test. For the proposed stakeholder management measurement model, only two of the twelve

indicator variables met this level: Institutional Weakness to Environment (.74) and Institutional Strengths to Diversity (.71).

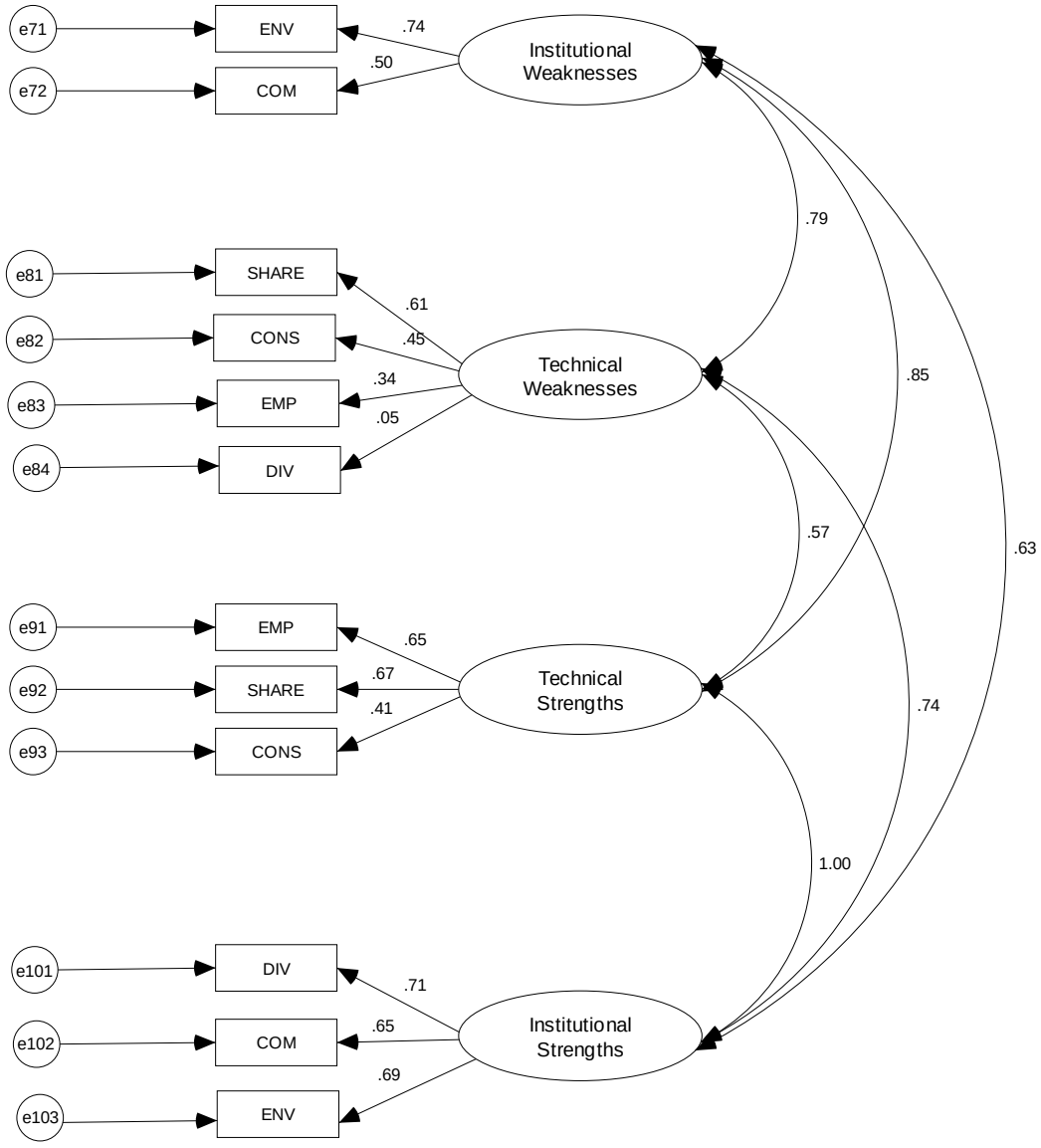

Figure 4.2: Confirmatory factor analysis results for proposed four-factor KLD model.

Furthermore, the reliabilities for each of the KLD subscales are presented in Table 4.6. The coefficient alpha for Institutional Strengths was acceptable at .72, however, the coefficient alphas of the remaining three factors were low (i.e., alphas ranged from .40 to .58, below the acceptable value of .70).

Table 4.6: Internal Coefficient Alphas for KLD Subscales (N = 195)

Subscale	Item N	Alpha
Institutional weaknesses	2	.53
Community		
Environment		
Institutional strengths	3	.72
Community		
Diversity		
Environment		
Technical weaknesses	4	.40
Employee		
Diversity		
Consumer		
Shareholder		
Technical strengths	3	.58
Consumer		
Shareholder		
Employee		

When the criteria from the above tests are satisfied, AMOS provides a series of indices of goodness-of-fit to assist researchers in assessing the overall measurement model. However, the above criteria were not satisfied, and the four-factor KLD measurement model findings were inadmissible as it did not yield a positive definite covariance matrix.

Therefore I tested two alternative versions for the KLD model (Kline, 2002). The alternative models were: a.) A two-factor model (strengths & weaknesses); and b.) A three-factor model based on an EFA.

a. Confirmatory Factor Analysis for the Two-Factor Model

Mattingly & Berman (2006) suggest that when using the KLD data to measure stakeholder management, it is inappropriate to load strengths and weaknesses together onto the same factor. Therefore, a confirmatory factor analysis was done to assess a revised two-factor measurement model of Stakeholder Management dividing the strengths and weaknesses manifest indicator variables into two separate latent variables. As with the prior CFAs, the convention was followed of assigning one regression weight linking the observed indicators to each latent factor be assigned a valued of 1.0; the other regressions weights were then calculated relative to the assigned weight.

Again, according to SEM convention, several tests of significance were utilized to make decisions as to the construct of latent factors within the model, i.e. which variables fit, or fail to fit, the hypothesized model, and whether certain variances or variables are correlated. Table 4.7 shows the results of this test. The first of these tests is the statistical significance of the parameter estimates. For each measured or observed variable, the p value for significance should be less than .05 (i.e., $p < .05$). All the indicator variables except Diversity Weaknesses (CR=.27; $p = .79$) met this level of significance.

Table 4.7: ML Estimates for Indicator Variables (KLD Two-Factor Model)

Path	B	S.E.	Beta	C.R.	Sig.
Weaknesses to:					
Shareholders	.66	.12	.50	5.58	.000
Consumers	.58	.13	.40	4.57	.000
Employees	.48	.12	.34	3.97	.000
Environment	1.00		.71		
Community	.54	.10	.51	5.65	.000
Diversity	.01	.04	.02	.27	.79
Strength to:					
Shareholders	.74	.08	.70	8.96	.000
Consumers	.31	.06	.42	5.37	.000
Diversity	.70	.08	.65	8.31	.000
Employees	.91	.10	.67	8.61	.000
Environment	1.00		.76		
Community	.79	.10	.59	7.59	.000

Second, the standardized regression weights linking indicator variables to latent variables should be greater than or equal to .70. Figure 4.3 illustrates the results of this test. For the proposed stakeholder management measurement model, only two of the twelve indicator variables met this level: Institutional Weakness to Environment (.74) and Institutional Strengths to Diversity (.71). In addition, the two factors were significantly correlated with each other ($r = .76, p < .001$).

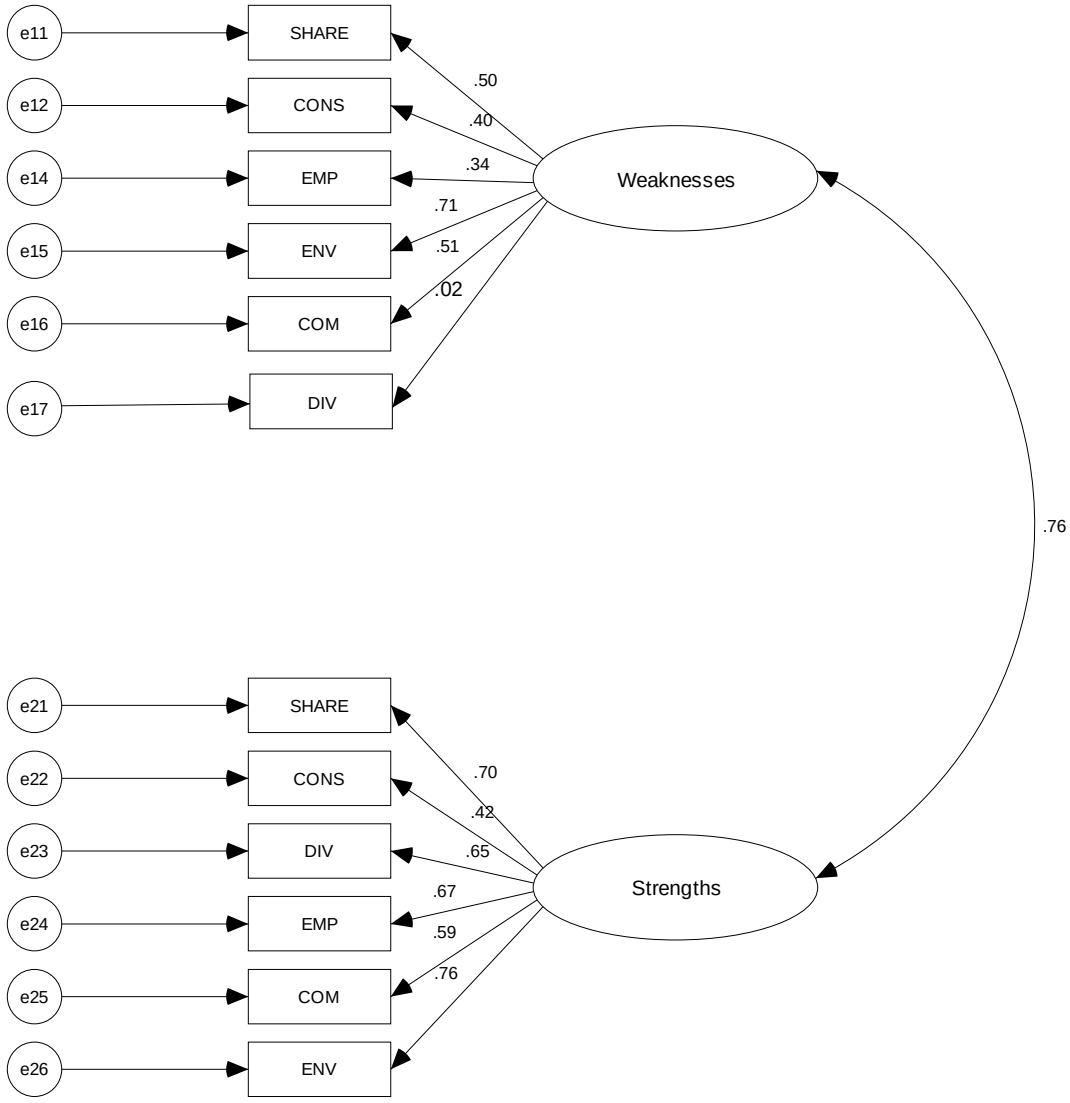

Figure 4.3: Confirmatory factor analysis for the two-factor KLD model.

When the criteria from the above tests are satisfied, AMOS provides a series of indices of goodness-of-fit to assist researchers in assessing the overall measurement model. However, the above criteria were not satisfied. With only two of the five indices barely in

the acceptable range, the two factor model did not fit the data well, as is shown in Table 4.8 below.

Table 4.8: Chi-square Results and Goodness of Fit Indices for KLD Two-Factor Model

Index	Value	Criteria
Chi-square	155.57	
Degrees of freedom	53	
Sig.	.00	
Chi-square/df	2.94	< 3.00
Adjusted goodness of fit index (AGFI)	.81	≥ .90
Normalized fit index (NFI)	.75	≥ .90
Comparative fit index (CFI)	.82	≥ .90
Root mean squared error (RMSEA)	.10	≤ .10

b. Confirmatory Factor Analysis for Three-Factor Model based on an Exploratory Factor Analysis

A final measurement model of the stakeholder factors was tested. Mattingly & Berman (2006) conducted an exploratory factor analysis to determine latent patterns of corporate social action in the KLD data. Exploratory factor analysis is typically used to test how and to what extent items relate to hypothesized constructs. The five year period of KLD data used by Mattingly and Berman (2006) to reduce the set of stakeholder factors went from 1998 through 2002. Although there is some knowledge about the relationships being measured, and it was hypothesized that the constructs should be consistent over time, there is no record of the 2007 KLD data being assessed for fit to the Mattingly & Berman taxonomy.

Thus, it was determined that an exploratory factor analysis using principle components analysis would be appropriate.

Eigen values were calculated to assess the nature and number of factors in the measure. Varimax factor rotation, the most common method, was used to help interpret the meaning of the factors. Varimax rotation attempts to maximize dispersion of the loadings within factors, loading smaller variables highly onto each factor. The rotation converged in 5 iterations. Tables 4.9 and 4.10 provide the results of the exploratory factor analysis.

Table 4.9: Factor Loadings for the Transformed KLD Subscales

Rotated Component Matrix[a]

	Component		
	1	2	3
TENV_STR	**.835**	.162	-.008
TSHARE_STR	**.684**	.271	.049
TENV_WEAK	.674	.045	.473
TEMP_STR	**.657**	.306	.020
TCONS_STR	**.579**	.057	-.156
TCOM_WEAK	.427	.254	.242
TCOM_STR	.268	**.777**	-.095
TDIV_STR	.354	**.762**	-.075
TCONS_WEAK	.022	.648	.181
TSHARE_WEAK	.166	.560	.342
TEMP_WEAK	.192	.003	**.760**
TDIV_WEAK	-.243	.132	**.559**

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 5 iterations.

Table 4.10: Variance Explained by the First Four Factors of the KLD Measure

Total Variance Explained

Component	Initial Eigen values			Rotation Sums of Squared Loadings
	Total	% of Variance	Cumulative %	Total
1	3.943	32.856	32.856	3.296
2	1.292	10.764	43.620	1.415
3	1.216	10.131	53.751	2.738
4	.957	7.979	61.730	

Extraction Method: Principal Component Analysis.

Building a measurement model for stakeholder management based on the EFA, items for each construct were included if the factor loading was greater than .50. However, because the KLD literature indicates that strengths and weaknesses should not be loaded onto the same factor (Mattingly & Berman 2006), the EFA results were modified so that each factor reflected only strengths or weaknesses, resulting in two strength factors consistent with Institutional and Technical Strengths (Mattingly and Berman), but only one Weakness factor. The first component was labeled Technical Strengths and retained items for environmental, shareholder, employee and consumer strengths, consistent with Mattingly & Berman's (2006) taxonomy. Likewise, the second factor retaining items for community and diversity strengths is consistent with the Institutional Strengths category in Mattingly & Berman's (2006) taxonomy. Only the items employee and diversity weaknesses loaded strongly on the remaining component, partially consistent with the Technical Weaknesses factor in Mattingly & Berman's (2006) taxonomy (which also included consumer and shareholder weaknesses). The items community and environmental weaknesses (Mattingly & Berman's Institutional

Weaknesses) either loaded on the Technical Strengths factor or they loaded simultaneously onto two factors and were therefore excluded.

Thereafter, a confirmatory factor analysis was done to assess the revised three-factor measurement model of Stakeholder Management dividing the manifest indicator variables into three latent variables: Technical Strengths, Institutional Strengths and Technical Weaknesses, as defined above. As with the prior CFAs, the convention was followed of assigning one regression weight linking the observed indicators to each latent factor be assigned a valued of 1.0; the other regressions weights were then calculated relative to the assigned weight.

Again, according to SEM convention, several tests of significance were utilized to make decisions as to the construct of latent factors within the model, i.e. which variables fit, or fail to fit, the hypothesized model, and whether certain variances or variables are correlated. Table 4.11 shows the results of this test. The first of these tests is the statistical significance of the parameter estimates. For each measured or observed variable, the p value for significance should be less than .05 (i.e., $p < .05$). All the indicator variables met this level of significance, thus the items loaded highly and significantly onto the constructs.

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Table 4.11: ML Estimates for Indicator Variables of 3-factor CFA

Path	B	S.E.	Beta	C.R.	Sig.
Technical strengths					
Shareholders	1.00		.71		
Employees	1.10	.15	.66	7.80	.000
Environment	1.14	.16	.81	8.87	.000
Consumers	.44	.08	.44	5.39	.000
Institutional strengths					
Community	1.12	.15	.75	7.46	.000
Diversity	1.00		.83		
Weaknesses					
Employees	1.00		1.00		
Diversity	.06	.03	.17	2.42	.016

The standardized factor loadings of the KLD subscales and the correlations between the KLD factors are illustrated in Figure 4.4. Further, the findings in Table 4.12 reveal that the factors were positively and statistically significantly correlated to each other, however they were not highly correlated with each other enough to have concerns regarding multicollinearity. Further, Technical Weaknesses and Institutional Strengths were not significantly correlated ($p = .129$).

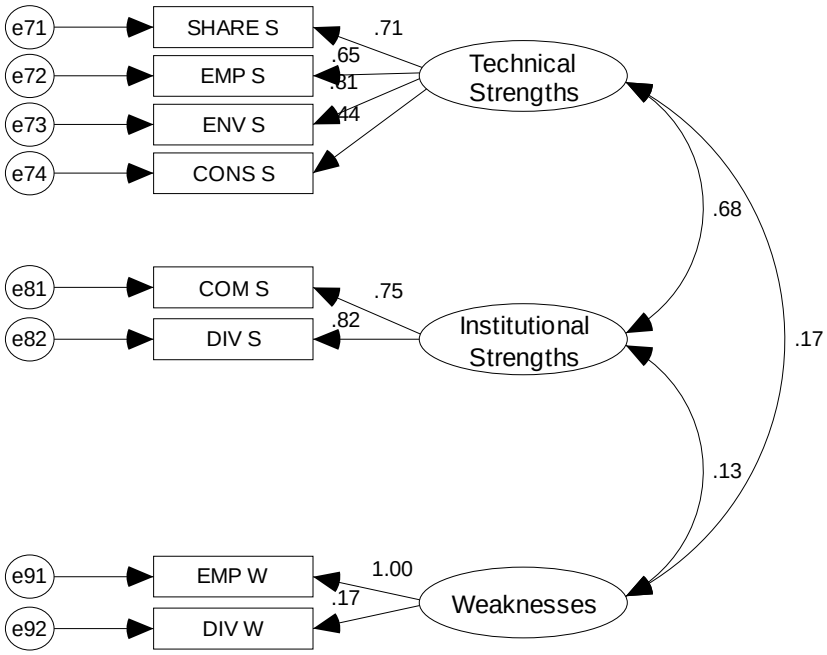

Figure 4.4: KLD Three-Factor Model

Table 4.12: Correlations between Constructs

Construct	TS		IS
Technical strengths (TS)			
Institutional strengths (IS)	.68	***	
Technical Weaknesses (TW)	.17	*	.13

* $p < .05$. ** $p < .01$. *** $p < .001$.

AMOS provides a series of indices of goodness-of-fit to assist researchers in assessing the overall measurement model. All five indices were in the good range, thus the three factor model did fit the data very well, as is shown in Table 4.13 below.

Table 4.13: Chi-square Results and Goodness of Fit Indices for the KLD Three-Factor Model (Emp W and Div W)

Index	Value	Criteria
Chi-square	24.72	
Degrees of freedom	18	
Sig.	.13	
Chi-square/df	1.37	< 3.00
Adjusted goodness of fit index (AGFI)	.94	≥ .90
Normalized fit index (NFI)	.93	≥ .90
Comparative fit index (CFI)	.98	≥ .90
Root mean squared error (RMSEA)	.04	≤ .10

B. Structural Equation Model and Hypotheses Tests

1. Proposed Structural Model Test. The first structural model tested was the model as originally proposed. Table 4.14 shows that none of the goodness of fit indices was within the acceptable range of criteria, thus, the model did not fit the data well. The standardized factor loadings and path coefficients are illustrated in Figure 4.5.

Table 4.14: Chi-square Results and Goodness of Fit Indices for the Proposed Structural Model

Index	Value	Criteria
Chi-square	1593.01	
Degrees of freedom	471	
Sig.	.000	
Chi-square/df	3.38	< 3.00
Adjusted goodness of fit index (AGFI)	.60	≥ .90
Normalized fit index (NFI)	.68	≥ .90
Comparative fit index (CFI)	.75	≥ .90
Root mean squared error (RMSEA)	.11	≤ .10

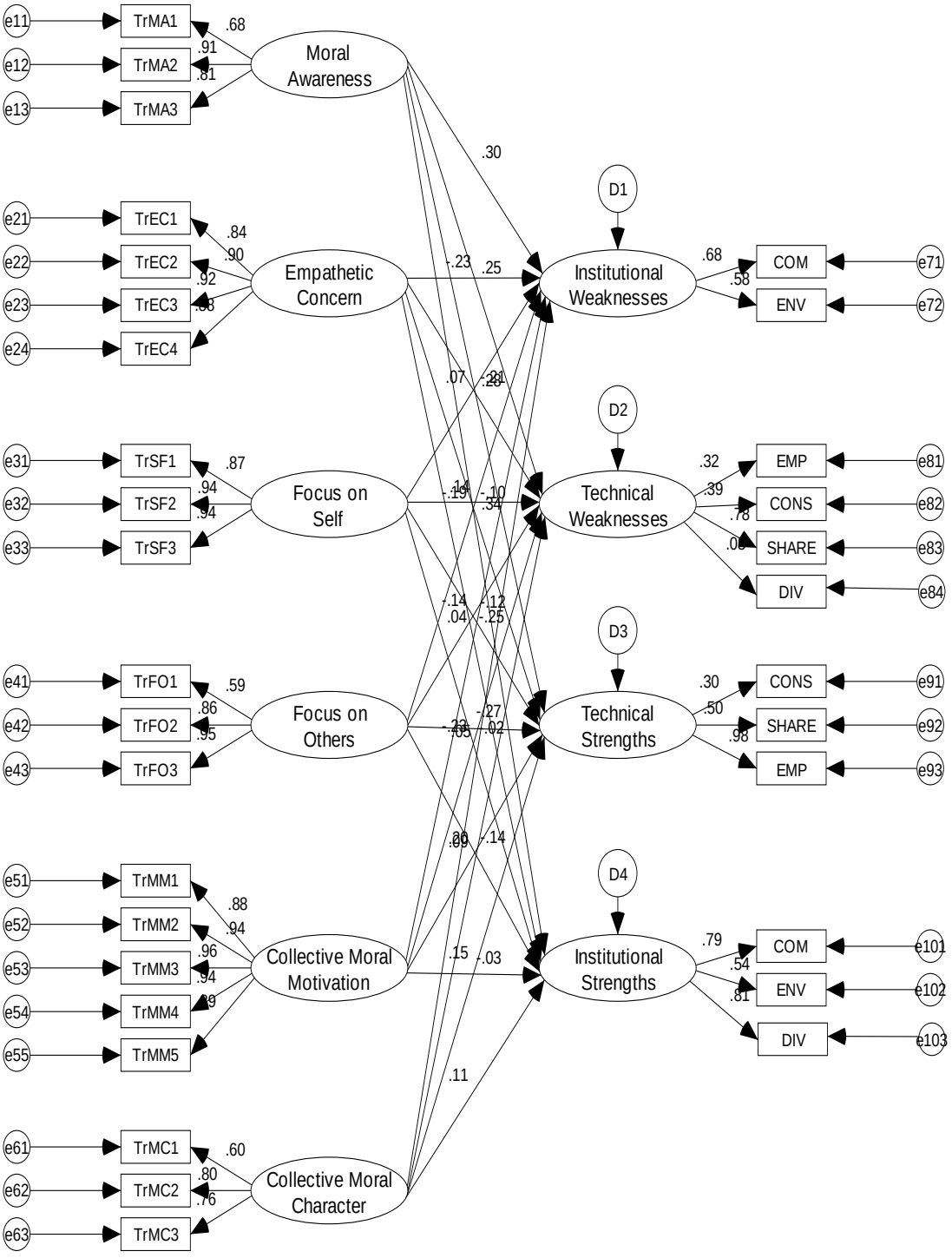

Figure 4.5: Results for the Full Proposed Structural Model.

2. Alternative Model Test. Since the proposed structural model did not fit the data well, a second model was tested. Instead of four endogenous constructs, only three endogenous constructs were used: Technical Strengths, Institutional Strengths and Weaknesses. This was based on the three-component stakeholder measurement model above. Standardized factor loadings and path coefficients are illustrated in Figure 4.6.

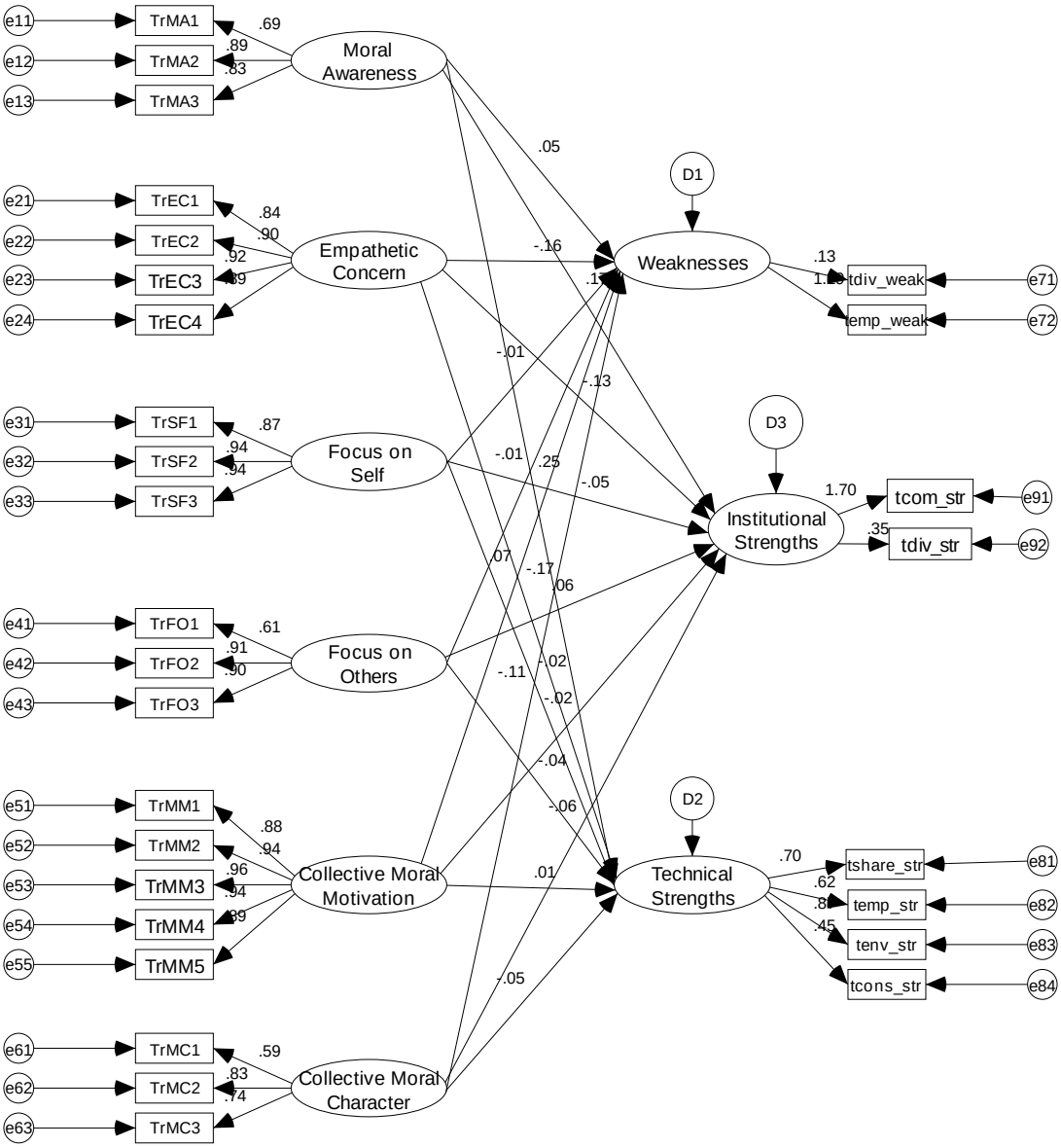

Figure 4.6: Results for the alternative structural model based on KLD 3-factor CFA.

The solution to this model was inadmissible as it yielded non-significant negative error variances ("Heywood cases"), which are not possible in the population. Heywood cases can indicate lack of fit, but that is not the only possible cause: sampling fluctuations or under-identification of the model can also cause Heywood cases (Dillon, Kumar, & Mulani, 1987). Furthermore, improper results can occur where sample sizes are smaller than the recommended 5 cases per parameter estimate (Bentler & Chou, 1987), which is the case in the current study when the entire structural model is tested (117 parameters). At this point, there is nothing to be done about sample size. However, for model identification issues, Bollen has identified the three-indicator rule, which requires each latent variable to have three manifest indicators (Bollen, 1989). Two-indicator factors are permissible only if the factors are allowed to correlate (an oblique solution). In the current 3-factor model, there are two uncorrelated factors with only two indicators: Institutional Strengths and Weaknesses.

3. Best Fitting Full Structural Model Test. Based on the modification indices, the CFA results, and theory, the model was altered to improve identification according to Bollen's three-factor rule by adding the two KLD indicators that are theoretically linked to Technical Weakness and allowing the error terms of the endogenous strength factors to correlate. Further, based on the Ethical Climate CFA results, exogenous latent variables with correlations above .70 were allowed to correlate and one of the exogenous constructs, Collective Moral Character, was deleted from the model as it was highly correlated with most of the other exogenous constructs. The standardized factor loadings and path coefficients are illustrated in Figure 4.7.

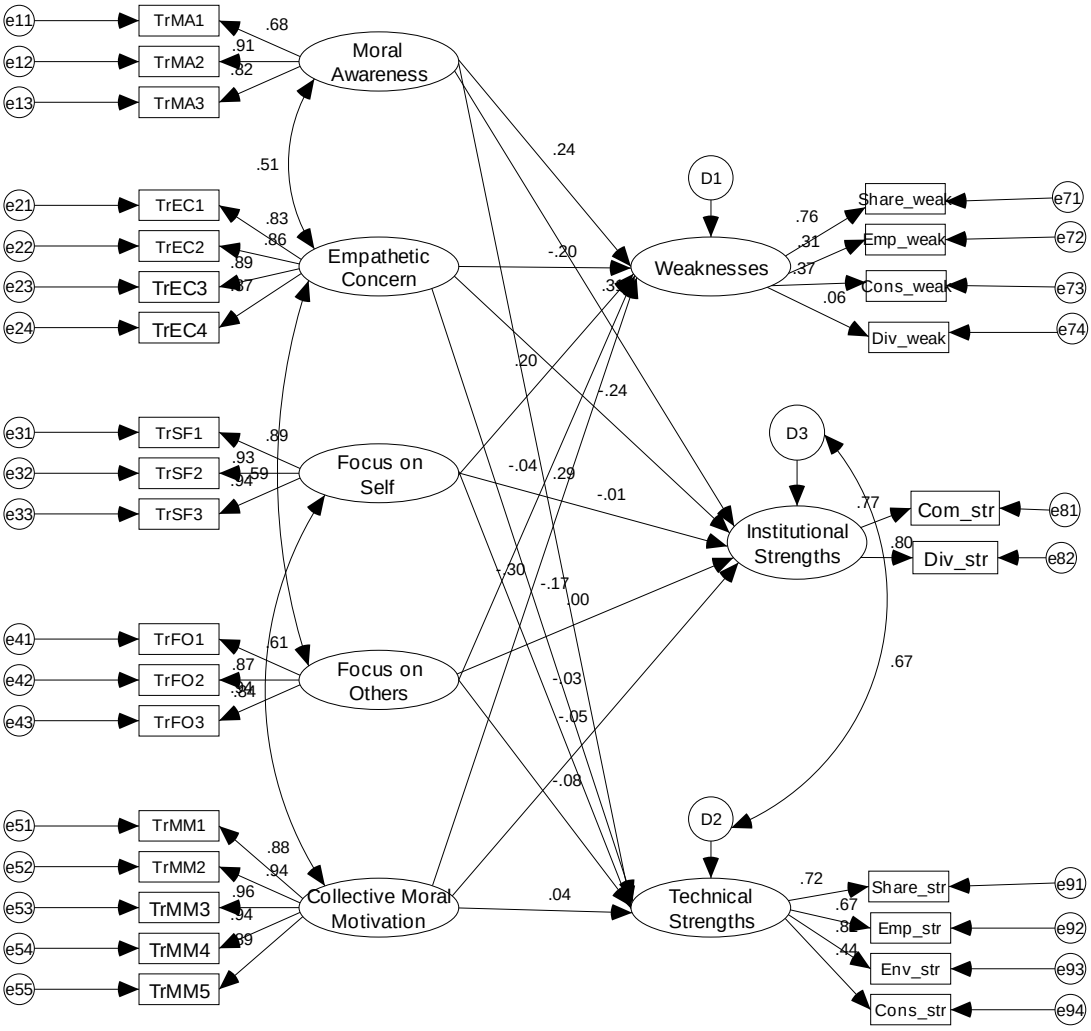

Figure 4.7: Results for the best-fitting full structural model.

The model fit the data fairly well (as is shown in Table 4.15 below). The Chi-square/df was below 3, the CFI was above .90 and the RMSEA was fairly good at .066. The findings in Table 4.16 indicate the maximum likelihood estimates for the hypothesized paths. Two paths were statistically significant and in the predicted direction: Moral Awareness explained 28.5% of the variation in Technical Strengths ($p = .024$); and Moral Awareness explained 30.6% of the variation in Institutional Strengths ($p = .012$).

Table 4.15: Chi-square Results and Goodness of Fit Indices for the Best-Fitting Structural Model

Index	Value	Criteria
Chi-square	612.819	
Degrees of freedom	331	
Sig.	.00	
Chi-square/df	1.85	< 3.00
Adjusted goodness of fit index (AGFI)	.778	≥ .90
Normalized fit index (NFI)	.860	≥ .90
Comparative fit index (CFI)	.930	≥ .90
Root mean squared error (RMSEA)	.066	≤ .10

Table 4.16: Best-fitting Full Structural Model: ML Estimates for Hypothesized Paths

Path	B	S.E.	Beta	C.R.	Sig.
Moral awareness to:					
Technical strengths	.18	.08	.29	2.25	.024
Institutional strengths	.62	.25	.31	2.51	.012
Weaknesses	.43	.25	.24	1.75	.080
Empathetic concern to:					
Technical strengths	-.12	.11	-.17	-1.14	.253
Institutional strengths	-.54	.34	-.24	-1.56	.118
Weaknesses	-.41	.35	-.20	-1.18	.237
Focus on self to:					
Technical strengths	-.02	.07	-.03	-.21	.836
Institutional strengths	-.01	.24	-.01	-.05	.957
Weaknesses	.26	.24	.20	1.08	.279
Focus on others to:					
Technical strengths	-.04	.06	-.08	-.62	.538
Institutional strengths	.01	.208	.00	.03	.977
Weaknesses	.06	.23	-.04	-.30	.765
Collective moral motivation to:					
Technical strengths	.02	.07	.04	.28	.783
Institutional strengths	-.06	.22	-.05	-.30	.768
Weaknesses	-.36	.22	-.30	-1.62	.105

4. Partial Model A: Collective Moral Sensitivity. While the best-fitting full model had acceptable goodness of fit scores, most of the structural model paths were non-significant. To ensure that small sample size was not obscuring significant relationships in the complex model with so many parameters, four partial models with fewer parameters were tested. The first partial model tests the relationship between social action toward stakeholders and Moral Sensitivity (made up of Moral Awareness and Empathetic Concern). This model was generated using the correlations and endogenous variables from the best-fitting full model, which were based on prior modification indices, CFA results, and theory. The model fit the data acceptably well (as is shown in Table 4.17 below). The Chi-square/df was below 3, the CFI was above .90 and the RMSEA was fair at .062. The standardized factor loadings and path coefficients are illustrated in Figure 4.8.

Table 4.17: Partial Model A – Collective Moral Sensitivity Model Fit Data

Index	Value	Criteria
Chi-square	192.081	
Degrees of freedom	111	
Sig.	.00	
Chi-square/df	1.73	< 3.00
Adjusted goodness of fit index (AGFI)	.855	$\geq .90$
Normalized fit index (NFI)	.882	$\geq .90$
Comparative fit index (CFI)	.946	$\geq .90$
Root mean squared error (RMSEA)	.062	$\leq .10$

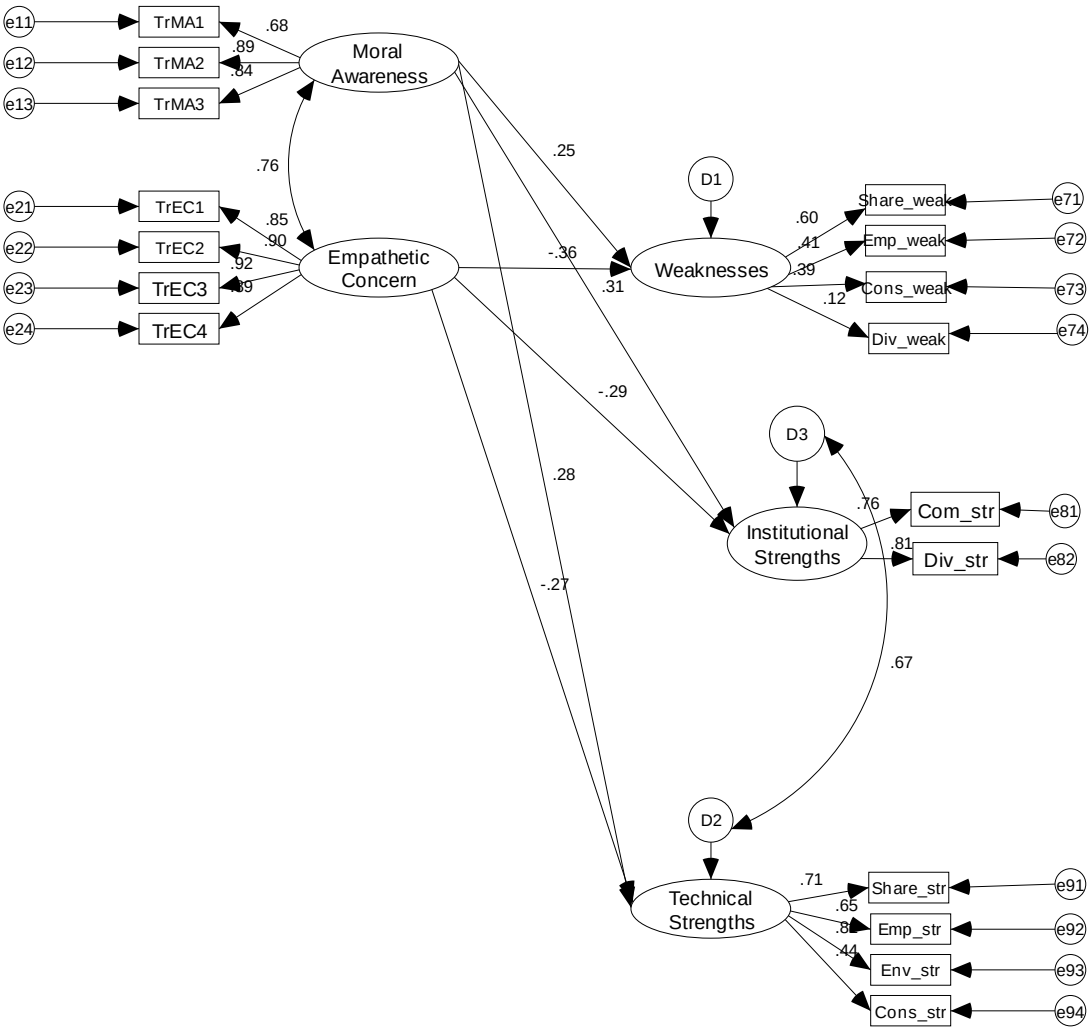

Figure 4.8: Partial Model A, Collective Moral Sensitivity

The findings in Table 4.18 indicate the maximum likelihood estimates for the hypothesized paths. One path was statistically significant and in the hypothesized direction: Moral Awareness was positively related to Institutional Strengths ($\beta = .312$; $P<.05$).

Table 4.18: Partial Model A: Collective Moral Sensitivity -- ML Estimates for Hypothesized Paths

Path	B	S.E.	Beta	C.R.	Sig.
Moral awareness to:					
Technical strengths	.17	.09	.28	1.83	.068
Institutional strengths	.60	.29	.31	2.05	.041
Weaknesses	.35	.26	.25	1.33	.183
Empathetic concern to:					
Technical strengths	-.16	.09	-.27	-1.80	.072
Institutional strengths	-.54	.28	-.29	-1.94	.052
Weaknesses	-.50	-.26	-.36	-1.91	.056

5. Partial Model B: Collective Moral Judgment. The second partial model tests Collective Moral Judgment: Focus on Self, Focus on Others. This model was generated using the correlations and endogenous variables from the best-fitting full model, which were based on prior modification indices, CFA results, and theory. The standardized factor loadings and path coefficients are illustrated in Figure 4.9. The model fit of the data was fairly acceptable (as is shown in Table 4.19 below). The Chi-square/df was below 3, the CFI was above .90 and the RMSEA was fair at .066. The findings in Table 4.20 indicate the maximum likelihood estimates for the hypothesized paths. None of the structure model paths were statistically significant.

Table 4.19: Partial Model B: Collective Moral Judgment Model Fit Data

Index	Value	Criteria
Chi-square	179.294	
Degrees of freedom	97	
Sig.	.00	
Chi-square/df	1.85	< 3.00
Adjusted goodness of fit index (AGFI)	.858	≥ .90
Normalized fit index (NFI)	.870	≥ .90
Comparative fit index (CFI)	.935	≥ .90
Root mean squared error (RMSEA)	.066	≤ .10

Table 4.20: Partial Model B: Collective Moral Judgment -- ML Estimates for Hypothesized Paths

Path	B	S.E.	Beta	C.R.	Sig.
Focus on Self to:					
Technical strengths	.01	.037	.02	.24	.809
Institutional strengths	-.04	.116	-.03	-.31	.755
Weaknesses	-.04	.112	-.03	-.33	.741
Focus on Others to:					
Technical strengths	-.03	.044	-.05	-.65	.518
Institutional strengths	-.05	.138	-.03	-.35	.728
Weaknesses	-.18	.136	-.14	-1.35	.177

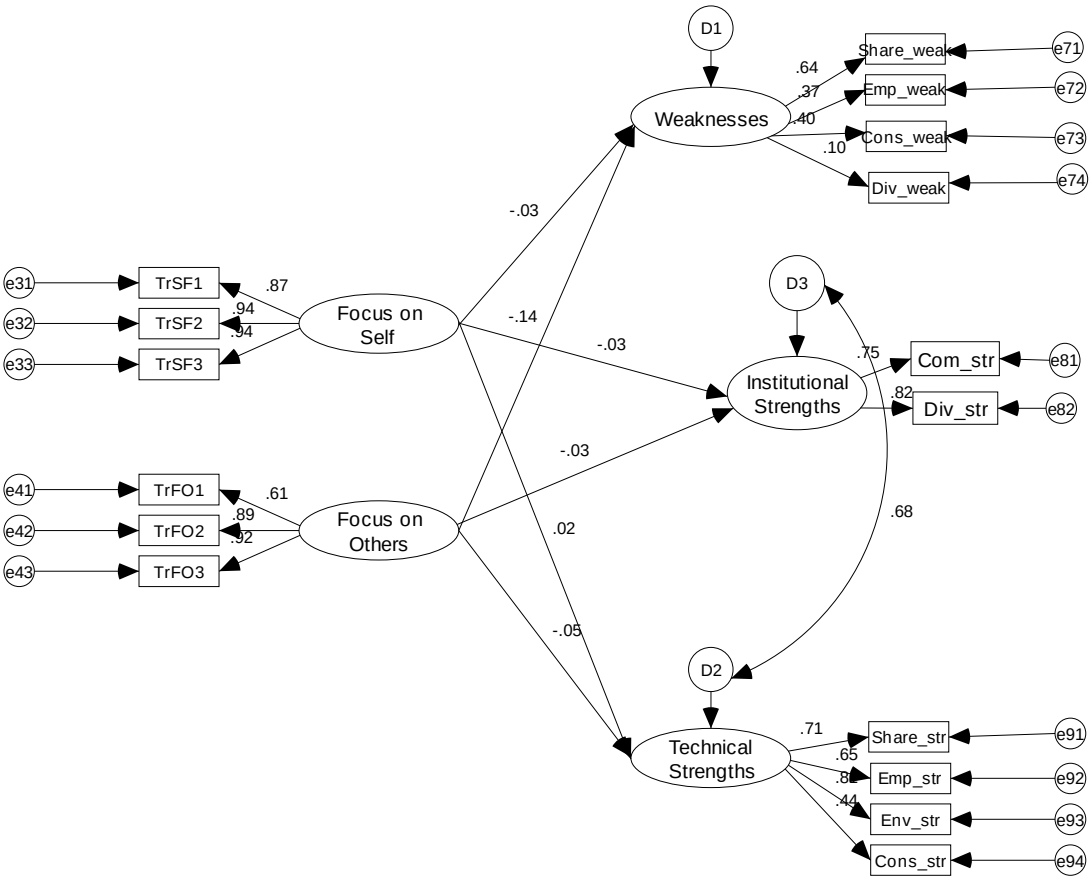

Figure 4.9: Partial Model B Collective Moral Judgment

6. Partial Model C: Collective Moral Motivation. The third partial model tests the relationship between Collective Moral Motivation and Stakeholder strengths and weaknesses. This model was generated using the correlations and endogenous variables from the best-fitting full model, which were based on prior modification indices, CFA results, and theory. The standardized factor loadings and path coefficients are illustrated in Figure 4.10. The model fit of the data was fairly acceptable (as is shown in Table 4.21 below). The Chi-square/df was below 3, the CFI was above .90 and the RMSEA was fair at .076. The findings in Table 4.22 indicate the maximum likelihood estimates for the hypothesized paths. None of the structure model paths were statistically significant.

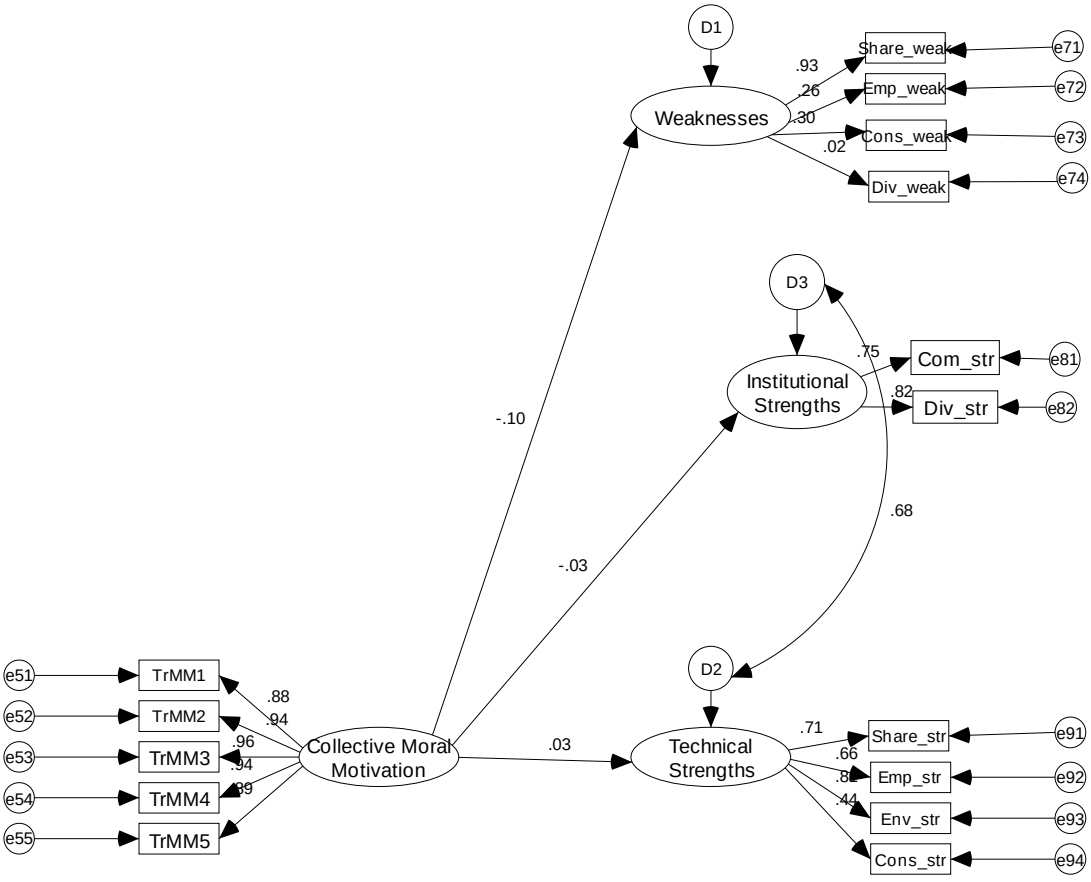

Figure 4.10: Partial Model C: Collective Moral Motivation

Table 4.21: Partial Model C: Collective Moral Motivation Model Fit Data

Index	Value	Criteria
Chi-square	181.808	
Degrees of freedom	86	
Sig.	.00	
Chi-square/df	2.11	< 3.00
Adjusted goodness of fit index (AGFI)	.855	≥ .90
Normalized fit index (NFI)	.898	≥ .90
Comparative fit index (CFI)	.943	≥ .90
Root mean squared error (RMSEA)	.076	≤ .10

Table 4.22: Partial Model C: Collective Moral Motivation -- ML Estimates for Hypothesized Paths

Path	B	S.E.	Beta	C.R.	Sig.
Collective Moral Motivation to:					
Technical strengths	.01	.034	.03	.38	.701
Institutional strengths	-.04	.106	-.03	-.39	.695
Weaknesses	-.15	.114	-.10	-1.34	.182

7. Partial Model D: Collective Moral Character. The fourth partial model tests the relationship between Collective Moral Character and Stakeholder Strengths and Weaknesses. This model was generated using the correlations and endogenous variables from the best-fitting full model, which were based on prior modification indices, CFA results, and theory. The standardized factor loadings and path coefficients are illustrated in Figure 4.11. The model fit of the data was acceptable but not as good as the other 3 partial models (as is shown in Table 4.23 below). The Chi-square/df was below 3 and the RMSEA was fair at .076, but the CFI was below .90. The findings in Table 4.24 indicate the maximum likelihood estimates for the hypothesized paths. None of the structure model paths were statistically significant.

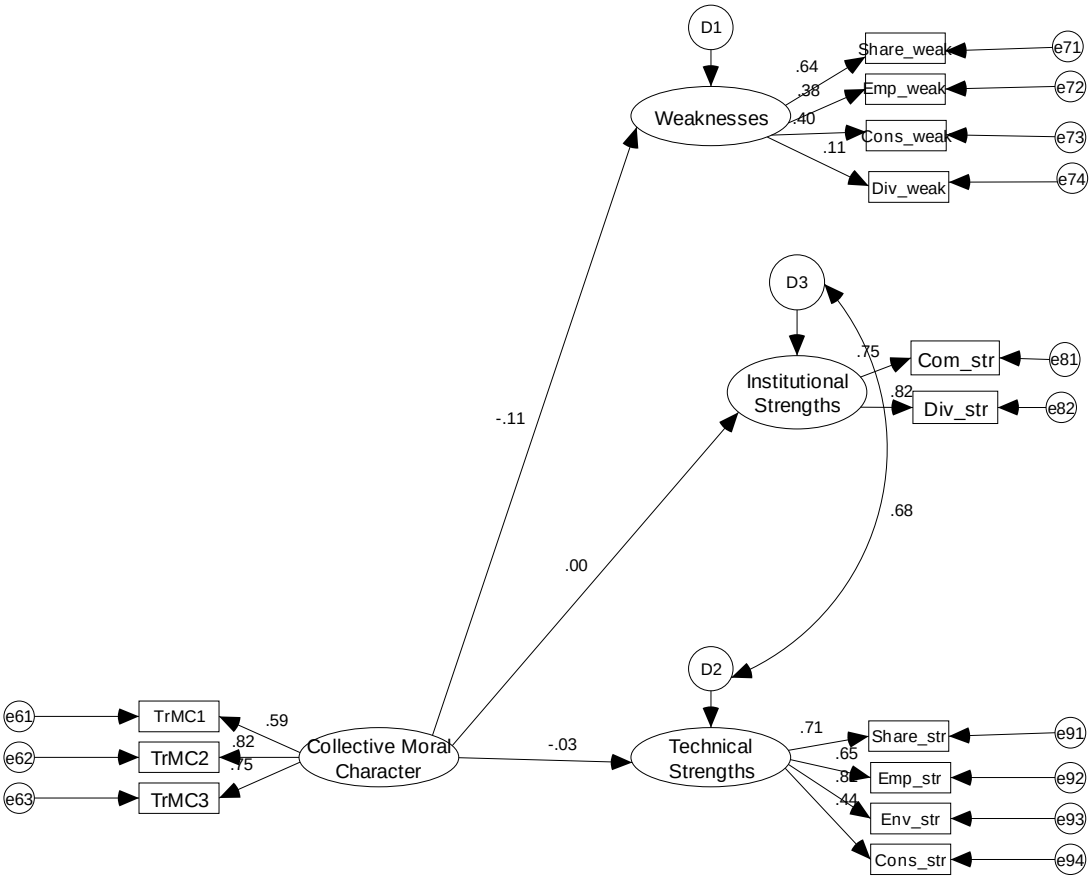

Figure 4.11: Partial Model D Collective Moral Character

Table 4.23: Partial Model D: Collective Moral Character Model Fit Data

Index	Value	Criteria
Chi-square	128.542	
Degrees of freedom	61	
Sig.	.000	
Chi-square/df	2.11	< 3.00
Adjusted goodness of fit index (AGFI)	.870	≥ .90
Normalized fit index (NFI)	.801	≥ .90
Comparative fit index (CFI)	.881	≥ .90
Root mean squared error (RMSEA)	.076	≤ .10

Table 4.24: Partial Model D: Collective Moral Character -- ML Estimates for Hypothesized Paths

Path	B	S.E.	Beta	C.R.	Sig.
Collective Moral Motivation to:					
Technical strengths	-.03	.077	-.03	-.39	.700
Institutional strengths	-.01	.239	-.00	-.02	.985
Weaknesses	-.22	.235	-.11	-.92	.358

C. Regressions

While the best-fitting full model as well as the partial models all had acceptable goodness of fit scores, most of the structural model paths were non-significant. To ensure that the structural model was not obscuring significant relationships, regression analysis was conducted to determine if significant relationships existed between elements of ethical climate and the twelve stakeholder indicators. To conduct the multiple regressions a mean score for each respondent was computed for each of the 6 ECI constructs.

To test whether relationships exist between components of ethical climate and the individual stakeholder indicators, a series of linear regression analyses were performed using the enter method. The equation in each case is as follows:

$$y = b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 + c.$$

Where y = the relevant stakeholder indicator (Community Strengths, Community Weakness, Share Strengths, Share Weaknesses, Consumer Strengths, Consumer Weaknesses, Diversity Strengths, Diversity Weaknesses, Employee Strengths, Employee Weaknesses, Environmental Strengths, or Environmental Weaknesses);

b_1 = the slope and x_1 = the mean of the Moral Awareness indicators;

b_2 = the slope and x_2 = the mean of the Empathetic Concern indicators;

b_3 = the slope and x_3 = the mean of the Focus on Self indicators;

b_4 = the slope and x_4 = the mean of the Focus on Others indicators;

b_5 = the slope and x_5 = the mean of the Collective Moral Motivation indicators;

b_6 = the slope and x_6 =the mean of the Collective Moral Character indicators; and

c = the constant (intercept).

There were only two regressions that indicated significant relationships: Community Strengths and Shareholder Weaknesses. In both these cases, the global F tests and adjusted R-square scores indicated that the models were neither significant nor strong.

The linear regression results for Community Strengths are displayed in Table 4.25. The global F test was 1.75, p = .111, indicating that that the model was not significant. The adjusted R-square was low at .023. The findings indicate that two of the Ethics variables significantly predicted Community Strengths. In particular, Moral Awareness was positively associated with Community Strengths (F = 7.51; *Beta* = .28; *p* = .007). Thus, the higher the Moral Awareness scores, the higher the Community Strengths scores. In addition, Empathetic Concern negatively predicted Community Strengths (F = 4.40; *Beta* = -.25; *p* = .037). The higher the Empathetic Concern scores, the lower the Community Strengths scores.

The linear regression results for Shareholder Weaknesses are displayed in Table 4.28. The global F test was .81, p = .564, indicating that that the model was not significant. The adjusted R-square was low at -.006. The findings indicate that one of the Ethics variables significantly predicted Shareholder Weaknesses. In particular, Collective Moral Motivation negatively predicted Shareholder Weaknesses (*Beta* = -.25, *p* = .049). The lower the Collective Moral Motivation scores, the higher the Shareholder Weakness scores.

It should be pointed out, however, that in all the regressions, the predictor variables were highly correlated with each other. The tolerance values were relatively low and ranged from .32 to .50. Thus, one must interpret these results with caution. The rest of the regression results are contained in Tables 4.26 through 4.36 and did not indicate any significant relationships between ethical climate components and stakeholder variables.

Table 4.25: Linear Regression Results for Community Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.67	.24	.28	7.51	.007	.50
Empathetic concern	-.56	.27	-.25	4.40	.037	.36
Focus on self	-.17	.23	-.09	.55	.461	.32
Focus on others	.20	.28	.09	.53	.468	.37
Collective moral motivation	-.03	.21	-.02	.02	.883	.33
Collective moral character	-.11	.26	-.04	.17	.681	.48
Overall model				1.75	.111	

Note. R^2 for model = .05; R^2 adj. for model = .023; S.E. .63.

Table 4.26: Linear Regression Results for Community Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.23	.19	.13	1.58	.211	.50
Empathetic concern	-.13	.20	-.08	.41	.522	.36
Focus on self	-.17	.17	.13	.97	.325	.32
Focus on others	-.08	.21	-.05	.15	.695	.37
Collective moral motivation	-.05	.16	-.04	.08	.773	.33
Collective moral character	-.07	.19	-.04	.14	.712	.48
Overall model				.82	.555	

Note. R^2 for model = .03; R^2 adj. for model = -.01; S.E. .48.

Table 4.27: Linear Regression Results for Share Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.28	.20	.15	2.09	.150	.50
Empathetic concern	-.25	.21	-.14	1.31	.254	.36
Focus on self	-.08	.18	-.06	.20	.658	.32
Focus on others	.22	.22	.12	.97	.327	.37
Collective moral motivation	.13	.17	.10	.60	.438	.33
Collective moral character	-.34	.21	-.17	2.75	.099	.48
Overall model				1.02	.414	

Note. R^2 for model = .03; R^2 adj. for model = .001; S.E. .51.

Table 4.28: Linear Regression Results for Share Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.14	.23	.06	.35	.555	.50
Empathetic concern	-.17	.25	-.08	.46	.500	.36
Focus on self	.30	.22	.18	1.93	.166	.32
Focus on others	-.01	.26	-.01	.002	.967	.37
Collective moral motivation	-.38	.19	-.25	3.91	.049	.33
Collective moral character	.12	.24	.05	.23	.633	.48
Overall model				.81	.564	

Note. R^2 for model = .03; R^2 adj. for model = -.006; S.E. .59.

Table 4.29: Linear Regression Results for Diversity Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.05	.20	.03	.06	.807	.50
Empathetic concern	-.19	.22	-.11	.73	.393	.36
Focus on self	.06	.19	.04	.09	.767	.32
Focus on others	-.05	.23	-.03	.04	.838	.37
Collective moral motivation	-.04	.17	-.03	.05	.831	.33
Collective moral character	.19	.21	.09	.79	.375	.48
Overall model				.26	.955	

Note. R^2 for model = .01; R^2 adj. for model = -.02; S.E. .52.

Table 4.30: Linear Regression Results for Diversity Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.01	.09	.01	.003	.955	.50
Empathetic concern	-.03	.10	-.03	.07	.795	.36
Focus on self	-.08	.08	-.13	1.02	.313	.32
Focus on others	.05	.10	.06	.21	.647	.37
Collective moral motivation	.06	.07	.09	.55	.458	.33
Collective moral character	-.06	.09	-.07	.48	.491	.48
Overall model				1.26	.953	

Note. R^2 for model = .01; R^2 adj. for model = -.02; S.E. .23.

Table 4.31: Linear Regression Results for Employee Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.36	.25	.14	2.05	.154	.50
Empathetic concern	-.10	.27	-.05	.14	.706	.36
Focus on self	-.22	.23	-.12	.88	.349	.32
Focus on others	.47	.28	-.12	2.77	.098	.37
Collective moral motivation	.35	.21	.21	2.75	.099	.33
Collective moral character	.36	.26	.14	1.93	.166	.48
Overall model				1.41	.211	

Note. R^2 for model = .04; R^2 adj. for model = .01; S.E. .64.

Table 4.32: Linear Regression Results for Employee Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.04	.24	.02	.03	.866	.50
Empathetic concern	-.38	.26	-.17	2.15	.145	.36
Focus on self	-.02	.22	-.01	.01	.915	.32
Focus on others	-.04	.27	-.02	.02	.883	.37
Collective moral motivation	.15	.20	.09	.59	.445	.33
Collective moral character	-.28	.25	-.12	1.29	.257	.48
Overall model				2.71	.015	

Note. R^2 for model = .08; R^2 adj. for model = .05; S.E. .61.

Table 4.33: Linear Regression Results for Environmental Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.32	.25	.13	1.64	.202	.50
Empathetic concern	-.21	.27	-.10	.62	.431	.36
Focus on self	.05	.23	.03	.04	.838	.32
Focus on others	-\.18	.28	-.08	.41	.526	.37
Collective moral motivation	.08	.21	-.05	.15	.703	.33
Collective moral character	.13	.26	.05	.24	.627	.48
Overall model				.43	.861	

Note. R^2 for model = .01; R^2 adj. for model = -.02; S.E. .63.

Table 4.34: Linear Regression Results for Environmental Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.23	.38	.09	.84	.362	.50
Empathetic concern	-.34	.25	-.15	1.61	.207	.36
Focus on self	-.13	.23	-.07	.32	.570	.32
Focus on others	.09	.28	.04	.11	.741	.37
Collective moral motivation	.19	.21	.12	.85	.359	.33
Collective moral character	-.21	.26	-.08	.63	.428	.48
Overall model				.78	.583	

Note. R^2 for model = .03; R^2 adj. for model = -.007; S.E. .64.

Table 4.35: Linear Regression Results for Consumer Strengths

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	-.04	.14	-.03	.06	.804	.50
Empathetic concern	-.06	.15	-.46	.14	.706	.36
Focus on self	-.17	.13	-.17	1.71	.193	.32
Focus on others	.01	.16	.01	.01	.934	.37
Collective moral motivation	.05	.12	.06	.20	.654	.33
Collective moral character	.03	.15	.02	.03	.861	.48
Overall model				.53	.784	

Note. R^2 for model = .02; R^2 adj. for model = -.015; S.E. .36.

Table 4.36: Linear Regression Results for Consumer Weaknesses

Variable	B	SE	Beta	F	Sig.	Tol.
Moral awareness	.21	.26	.08	.66	.417	.50
Empathetic concern	-.19	.28	-.08	.45	.503	.36
Focus on self	-.10	.24	-.05	.18	.673	.32
Focus on others	.01	.29	.003	.001	.979	.37
Collective moral motivation	-.12	.22	-.07	.31	.579	.33
Collective moral character	-.07	.27	-.03	.06	.800	.48
Overall model				.52	.791	

Note. R^2 for model = .02; R^2 adj. for model = -.02; S.E. .66.

Chapter 5: Discussion and Conclusion

A. Summary of Findings

The purpose of this study is to test the relationship between ethical climate and social actions toward stakeholders. Specifically this model posits that sub-components of a measure of organizational ethical climate based on Rest's (1984, 1986) four step ethical decision making process are linked to social action toward stakeholders, grouped according to Mattingly & Berman's (2006) stakeholder taxonomy. Using a pre-existing database of ethical climate responses and the 2007 KLD database to measure social action toward stakeholders, this study tests a structural path model using maximum likelihood structural equation modeling (ML-SEM). Because the KLD database does not load on four factors as predicted by Mattingly & Berman's (2006) taxonomy, not all hypotheses could be tested—specifically, not those dealing with the factor Institutional Weaknesses. The results of this analysis support some of the hypothesized relationships in the model but not most. A summary of the results regarding the tests of hypotheses is provided in Table 5.1.

Table 5.1: Results of Hypotheses Tests using ML-SEM

HYPOTHESES	**RESULTS**
Moral Sensitivity	
H1a. Moral Awareness will be negatively related to Institutional Weaknesses.	Not tested
H1b. Moral Awareness will be negatively related to Technical Weaknesses.	Not Supported
H1c. Moral Awareness will be positively related to Technical Strengths.	**Supported**
H1d. Moral Awareness will be positively related to Institutional Strengths.	**Supported**
H2a. Empathetic Concern will be negatively related to Institutional Weaknesses.	Not tested
H2b. Empathetic Concern will be negatively related to Technical Weaknesses.	Not Supported
H2c. Empathetic Concern will be positively related to Technical Strengths.	Not Supported
H2d. Empathetic Concern will be positively related to Institutional Strengths**.**	Not Supported
Moral Judgment	
H3a. Focus on Self will be positively related to Institutional Weaknesses.	Not tested
H3b. Focus on Self will be negatively related to Technical Weaknesses.	Not Supported
H3c. Focus on Self will be positively related to Technical Strengths.	Not Supported
H3d. Focus on Self will be negatively related to Institutional Strengths.	Not Supported
H4a. Focus on Others will be negatively related to Institutional Weaknesses.	Not tested
H4b. Focus on Others will be negatively related to Technical Weaknesses.	Not Supported
H4c. Focus on Others will be positively related to Technical Strengths.	Not Supported
H4d. Focus on Others will be positively related to Institutional Strengths.	Not Supported
Collective Moral Motivation	
H5a. Collective Moral Motivation will be negatively related to Institutional Weaknesses.	Not tested
H5b. Collective Moral Motivation will be negatively related to Technical Weaknesses.	Not Supported
H5c. Collective Moral Motivation will be positively related to Institutional Strengths.	Not Supported
H5d. Collective Moral Motivation will be positively related to Technical Strengths.	Not Supported

Table 5.1 (cont'd): Results of Hypotheses Tests using ML-SEM

Collective Moral Character	
H6a. Collective Moral Character will be negatively related to Institutional Weaknesses.	Not tested
H6b. Collective Moral Character will be negatively related to Technical Weaknesses.	Not Supported
H6c. Collective Moral Character will be positively related to Institutional Strengths.	Not Supported
H6d. Collective Moral Character will be positively related to Technical Strengths.	Not Supported

B. Discussion

In this study, the only group of hypotheses that is partially supported relates to the first component of ethical climate regarding the relationship of moral sensitivity to stakeholder relationships. The only significant results have to do with moral awareness which is positively related to strengths in both technical and institutional stakeholder relationships. Moral awareness explains 28.5% of the variation in technical strengths ($p < .05$); and moral awareness explains 30.6% of the variation in institutional strengths ($p < .05$). These results hold in both the full model, as well as the partial model reflecting only moral sensitivity, where one path is statistically significant and in the hypothesized direction: moral awareness is positively related to institutional strengths, explaining 31.2% of the variation ($p < .05$).

One surprising result in these findings is the lack of any relationship between moral judgment, the second step in Rest's (1984, 1986) ethical decision-making process, and stakeholder relationships. The non-significance of moral judgment against any of the various stakeholder variables is an interesting finding in itself. Out of all the components in the ECI measure, the moral judgment component is based on the most established theoretical and empirical literature. The constructs and questions for focus on self and focus on others are

drawn directly from Victor & Cullen's (1984, 1986) Ethical Climate Questionnaire, the most frequently utilized measure of ethical climate in the past two decades. Victor & Cullen in turn rely on Kohlberg's (1973) long respected theory of moral development. More specifically to this study, Jones Felps & Bigley (2006)'s theoretical link between ethical culture and stakeholder salience relies on the concepts of focus on self and focus on others to define their stakeholder cultures. Therefore, of all the components tested in this study, the one most expected to produce significant results is moral judgment. The non-significant findings for this component are difficult to explain, but could perhaps be attributed to either an empirical issue with the data or with the structural models employed in this study; or with a flaw in the underlying theoretical basis for the construct. Both of these issues will be discussed further below in terms of future research.

The non-significant findings regarding the link between moral motivation component (the third step in Rest's (1984, 1986) ethical decision making process) and social action toward stakeholders are similarly surprising. Given the vast amount of discussion in ethics literature as well as in practitioner circles regarding the importance of values in the corporate ethical climate, a significant relationship is expected between social action toward stakeholders and the underlying values that motivate behavior. Again, as discussed below, one avenue for future research is to reconfigure the empirical data and/or the structural models used in this study and explore whether the results are more in line with the underlying literature. Alternatively, perhaps future research could reconsider whether the theory of ethical decision making employed in developing this model, or whether another theory is most appropriate to explore a connection to corporate action towards stakeholders.

Likewise, much has been written about the importance of taking responsibility for ethical action, therefore the non-significant findings regarding the relationship between moral

character and social action toward stakeholders were unexpected. The following section on future research discusses how changes in data use and/or an amended structural path model might be used to further test the relationship between a firm's relationship with its stakeholders and its ethical climate based on Rest's (1984, 1986) four step decision making process. Alternatively a new theoretical model to be explored in future research is discussed below.

C. Future Research

Given the significant findings related to the link between moral awareness and strengths in stakeholder relationships, future research may extend this study by examining how moral awareness impacts other factors in the stakeholder stream of research. Specifically, given that a basic tenet of stakeholder research is that strong stakeholder relationships should improve a firm's competitive position, it would be interesting for future research to examine the links between moral awareness, stakeholder relationships, and firm economic performance.

On the other hand, the extent of non-significant findings found in this study indicates two other general paths for further research; one related to the way this theory was tested empirically, and a second exploring the impact that other theories of ethical decision making could have on stakeholder relationships. The first path assumes the underlying theory suggesting a relationship between the ECI's four components of ethical climate and social action toward stakeholder is sound, however either the data or the structural model as specified is flawed. Therefore this first stream of future research would 1.) attempt to make better use of the current data to try to account for sampling fluctuations, 2.) attempt to reconfigure the structural model to better reflect the theory, and 3.) gather additional data or use different sources of data. The intent of this research would be to eliminate any type-II

errors (failure to find significant relationships that exist in the population) that may have occurred in this study.

For example, regarding sampling issues, the data used in this study includes respondents ranging from c-level executives to line workers. As some literature suggests that ethical climate is shaped mostly by top management (Trevino et al., 1998; Trevino & Youngblood, 1990), one strategy for further research using the immediate dataset is to retest the given model selecting only those respondents in the ethical climate dataset above a certain level of responsibility (e.g., vice-president) and re-test the structural model. Some open questions with this approach relate to whether the position level indicators provided by respondents in the demographic section of the survey are sufficiently distinct to make a clear division regarding level of responsibility and whether there will be enough high-level executives remaining in the data set matched with KLD data to have a reasonable sample size.

Another possibility that could contribute to the non-significant findings in this study is the nature of the KLD data used as a measure of social action toward stakeholders. Recent research has empirically explored how well social ratings data such as KLD actually measure social responsibility to certain stakeholder groups, and have found problems with the nature of the measurement (Chatterji, Levine, & Toffel, 2009). Specifically, the KLD data on the natural environment was found to poorly predict certain aspects of environmental performance. Thus, if the KLD data is under-representing strengths or concerns vis a vis certain stakeholder groups, this could again generate type II errors, or false negative findings. Thus, one possibility for future research is to determine and test other measures for corporate action toward specific stakeholder groups. One such measure related to weaknesses in stakeholder management could be gathered from legal records related to past or ongoing litigation over

social issues. The data could include fines, sanctions and settlements related to social action on stakeholders.

Furthermore, one possible explanation for the lack of findings related to the second, third and fourth stages of ethical decision-making could be the way the model in this study configures the measurement model and the structural paths. Given that under Rest's (1984, 1986) theory, action is supposed to occur only as a result of the entire ethical decision making process, perhaps the model could be reconfigured to better reflect this theory. Rather than proposing a direct relationship between each ethical climate component and the various categories of stakeholders, perhaps it was necessary to draw paths through the entire ethical decision-making model first. Thus, Moral Sensitivity components would be related to Moral Judgment components, which would in turn be related to Moral Motivation, and which would be related to Moral Character. Only after following the complete four-step ethical decision-making process would paths be drawn to the stakeholder groupings to test the relationship between Ethical Decision-making and Stakeholder Management. A nested model approach in structural equation modeling might be useful to explore changes in the model in future research.

The second path for future research would reconsider the theoretical underpinnings of this study. The extent of non-significant findings in this study could be seen as an interesting finding in itself. Only one step –the first step of moral sensitivity--of the ethical decision-making process was found to be related to firm social action towards stakeholders. As a whole these results do not support the idea that the ethical climate of a firm as measured based on Rest's (1984, 1986) four step model can predict social action toward stakeholders. Stepping back and reconsidering the theoretical implications, it appears that these results instead are more consistent with a recent reconsideration and reconfiguration of the ethical decision-

making process based on the concept of sensemaking (Sonenshein, 2008), where moral sensitivity is a key step in ethical decision-making.

Sonenshein (2008) refutes the idea that ethical decision-making involves a rational process of deliberating moral principles and weighing evidence and values. Rather, he suggests that cognition evidence and theory support a sensemaking-intuition model (SIM) of responding to ethical issues at work. Recent neurological evidence supports the idea that non-conscious pattern-matching is used to respond to ethical issues, where moral intuitions—immediate "gut reactions"—determine behavior without any conscious, rational deliberative process. Furthermore, neurological studies have shown that more deliberate cognitive processing is used for post-hoc rationalization of intuitions rather than to actually make judgments about ethical issues. Thus when people become aware of a moral issue they immediately know *what* their response should be, and then they use rational processes to explain *why* they chose that response. In his SIM model, Sonenshein (2008) proposes three stages of ethical decision making: issue construction, intuition and explanation/justification. Issue construction involves moral awareness of an issue supplemented with a constructed interpretation of the meaning of that issue (Sonenshein, 2008: 1029). Once the interpretation of the ethical issue is constructed, the intuition stage is where an instantaneous affective reaction occurs, which functions as a moral judgment, and in which the individual determines "good" or bad", without any conscious deliberation. After the judgment is made, individuals justify or explain their reaction in post-hoc rationalization, which can include conscious rational analysis. Sonenshein points out that the distinctions between these three phases may be fuzzy in actual practice, "collapsing distinctions between cognition and action" (Sonenshein, 2008: 1035).

This dissertation did not set out to operationalize or test Sonenshein's (2008) sensemaking- intuition model, therefore the results could not be said to support his concept. Rather, this study was intended to assess support for the relationship between elements of the Rest (1984) rational decision-making process and the end result of strengths or weaknesses in stakeholder relationships. Interestingly, the results of this study are not consistent with the rational, deliberative ethical decision-making process at least when it comes to social action toward stakeholders. Instead, it appears that the initial phase of moral sensitivity, and particularly, moral awareness, is the most significant factor for engaging in ethical behavior toward stakeholders. The findings of this study seem to suggest a link between an alternative conception of ethical decision-making and social action toward stakeholders. Given this finding, future research is warranted that further develops the theoretical relationship between Sonenshein's sensemaking – intuition model of ethical decision-making and social action toward stakeholders. Thereafter, research to operationalize the sensemaking-intuition model and empirically assess its actual impact on stakeholder relationships would be valuable. This is worthy of further investigation, including deeper consideration of factors that contribute to moral awareness or issue construction, for example moral intensity (Jones, 1991).

D. Implications for Practitioners and Policy.

The results of this study and of the future studies to be conducted in this line of research have interesting implications for practitioners—the Corporate Ethics and Compliance Officers (CECOs) who are responsible for ethics and compliance programs in most large American firms. Practitioners trying to influence organizational behavior have long relied on the rational ethical decision making models underlying the "command and control" regulatory scheme discussed in Chapter 1 above. Considerable efforts have been made by many CECOs to reshape the employee's rational process of deliberating principles (Rest's step 2) and

weighing of values (Rest's step 3) by changing the weighting of consequences of unethical behavior. This includes efforts such as publicizing penalties for unethical actions and programs linking incentive plans to legal compliance. Other firms have spent their energy attempting to empower employees to take action on ethical issues—relating to building moral character, the fourth and final step of Rest's (1984) process. One example is Kraft's Speak Up and Be Heard program, discussed in Chapter 2 above. However, if the data in this and future studies do not support a link between a rational, deliberative model of ethical decision-making, and outcomes such as social action toward stakeholders, then perhaps CECO efforts are not being most efficiently deployed. If future research supports that ethical action is more likely to result from an intuitive model rather than a rational model of cognition, the limited resources of corporate ethics and compliance programs could be more effectively deployed to impact moral awareness and issue framing in order to ensure that ethical behavior ensues.

Sonenshein (2008) suggests that deliberation and weighing of consequences actually occurs as post-hoc rationalization once the ethical decision is already intuitively made. Further, he suggests that the rationalization process is unlikely to alter the original intuitive decision—even when significant new information is presented. If this is the case, then arguably efforts by CECOs to influence behavior through changing the balance of the rational decision-making model may amount to too little too late. Perhaps CECO efforts to increase employee moral awareness and empathy and to reinforce the identity-affective response that leads to intuitively ethical behavior would be more effective. Program based on a sensemaking-intuitive model of ethical decision making could be applied more generally to encourage ethical climates that lead to good corporate citizenship, as required by the Federal Sentencing Guidelines. More study is necessary to determine which types of corporate ethics programs can most effectively promote moral sensitivity and whether they are also effective in promoting more ethical conduct.

On that note, the results of this study and of future work in this line of research also have interesting implications for future changes in the regulatory environment seeking to promote corporate citizenship. If research supports that more ethical behavior is enabled (or illegal behavior prevented) when an affective response is triggered by moral sensitivity, then legislation could better reflect that point. More legislation could be designed along the lines of chapter 8 of the Federal Sentencing guidelines that requires firms to promote an ethical culture that encourages ethical conduct, focusing specifically on raising moral awareness among employees. The question remains whether more disclosure requirements such as those contained in the SEC regulations or the Sarbanes Oxley legislation are as effective in preventing illegal behavior, particularly when disclosure in the form of prospectuses can be so obtuse, legalistic and unintelligible. The challenge becomes to develop a regulatory environment that encourages the design of organizations that take account of human nature and foster the affective/empathetic dimension of moral sensitivity.

Literature suggests that where small communities are created within larger organizations, they become centers for the development of moral values and governing norms (Fort, 2001). Such firms become mediating institutions where there is a sense of empathy and compassion that makes members want to treat others well. Regulations that could promote the development of such communities within firms, rather than a check-the-box compliance mentality, may promote moral sensitivity and produce more ethical corporations. Those corporations in turn, may be more likely to develop stronger relationships with key stakeholders, benefitting both the firm and the stakeholders.

E. Limitations

This study is the result of an extensive review of empirical research on stakeholder management and ethical climate, and adheres to rigorous research standards. However, the study has some limitations that should be addressed or considered for future research.

The sample frame limits the context of the study to a segment of firms. The use of quantitative secondary sources limits the sample size available for analysis, with only 194 firms that have data in both databases. The selection of publicly traded companies as the focus of the study arises because of the limitations of coverage of the KLD data. This segment excludes many large privately owned companies, and many global companies not traded in the US and therefore not covered by KLD. This study also assumes that KLD ratings accurately capture patterns of activity and institutional behaviors, which cannot be independently empirically validated. Despite these limitations, KLD remains a respected database used frequently by management scholars. Future research exploring other data representing social action toward stakeholders, such as evidence of legal sanctions fines and settlements as discussed above, might overcome some of the inherent limitations of the KLD database.

The firm unit of analysis for this segment includes subjects with multiple subsidiaries, aggregating the climate and actions of individual strategic business units. Where there were multiple respondents for one firm, the ethical climate data was aggregated (where the r_{wg} statistic suggests acceptable agreement) to the collective firm level. There were an unequal number of raters per firm due to the nature of the sample, and a psychological measure using one respondent was the measure for the majority of firms. The GMI Panels for the ECI data are essentially convenience samples, and respondents are recruited and rewarded for GMI's market research purposes. All of these factors may introduce bias. Future research using data

with more consistent numbers of respondents per firm would be useful to overcome these limitations.

This study addresses the relationship between ethical climate and stakeholder relationships. It does not address other potential predictors or moderators such as financial performance, and it does not control for firm size or industry effect as the sample size is not large enough to allow for that. Future research could explore the differences contributed by these variables.

F. Conclusion.

Does the ethical climate of a firm impact the social actions firms take toward various stakeholder groups? This dissertation seeks to explore the link between two well developed streams of research, and in so doing, fill a gap within each of them. Within the scholarly work on ethical climate, there are only a few examples of empirical studies exploring the relationship between firm ethical climate and firm behavior toward specific types of stakeholder groups. This study contributes an elaboration of the theoretical basis for, as well as an empirical test of, the impact that a firm's ethical climate can have on its relationships with multiple stakeholders. Additionally, scholarly stakeholder research has recently turned to a consideration of the many factors that can promote or inhibit mutually beneficial firm-stakeholder relationships—from the perspective of both the firm and the stakeholders. While many researchers have suggested that firm culture can be a significant factor in how firm-stakeholder relationships develop and progress, the empirical test conducted in this dissertation begins to shed light on the nature of the impact of this factor on the relationship.

While most the findings are inconclusive due lack of statistical significance, nevertheless, there are indications that at least one aspect of an ethical climate, specifically, the moral sensitivity of employees, has an impact on how strong firm relations are with many

different stakeholder groups. The theoretical relationship expounded in this study merits further exploration.

These initial findings are relevant to future work in both academic and practitioner circles, as well as to public policy. This study continues the current debate in public policy and among practitioners about the appropriate requirements, methods and goals for corporate ethics and compliance programs. This dialogue must be underpinned by empirical support in order to ensure that public policy regulating how corporations go about improving their ethical behavior are most effectively designed to actually produce the desired benefit of mutually beneficial relationships between the firm and its external environment.

This study points toward several future research projects, including building on the theoretical direction highlighted herein, as well as new directions of empirical research. Among other things, future theoretical and empirical inquiry is warranted into how moral sensitivity, as part of the sensemaking-intuition model of ethical decision making, can impact firm-stakeholder relationships. This research stream could potentially pave the way for a major reassessment of the public policy and legal regulations governing how corporations invest their limited resources to encourage ethical behavior and develop beneficial stakeholder relationships.

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