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Impact of Management Ethics on Payment Discipline

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Abstract

A company's ethics is one of the key factors of its effectiveness. Having poor business ethics usually lead to the lack of payment discipline. The main purpose of the study was to identify the possible impact of management ethics on the financial discipline of companies. The study involved 273 Slovenian public and private companies, which represented 9.1% of all companies invited to take part in the survey. The data on management ethics were collected using the Corporate Ethical Virtues measurement instrument questionnaire and the data concerning average late payments were obtained from the database of the Slovenian rating agency "I d.o.o.". Statistical analysis was carried out using SPSS 20.0 for Windows. We conducted a factor analysis and a regression analysis using the stepwise method. We found that management ethics has a positive impact on payment discipline. At the end of the article, we give suggestions for improvement of payment discipline.

Keywords: payment discipline, late payments, ethic, management ethics, Slovene companies.

JEL classification: M14, G02

Introduction

Unfortunately, ethics are not as influential as they should be. Sims (1992) wrote in 1992 that unethical behaviour by companies was shockingly frequent. Circumstances have not changed considerably in the meantime. Research conducted in 2008 on a sample of 1,752 managers and employees from five countries showed that 16% of participants had noticed blackmail, 15% had noticed discrimination, 11% thievery and 7% forgery of cost reports in the last 12 months (Kaptein, 2011). Another study, which was also conducted in 2008, included 5,065 American managers and employees and showed that 74% had noticed unethical behaviour in their company in last 12 months (Kaptein, 2011). Based on these results, we can conclude that companies do not take enough account of ethics and laws. Applying business ethics should be part of the change in company policy and should be present at all levels of the control and management process, both at the implementation level of that process and working routine (Belaket al., 2011).

"Decisions on ethical issues are complex and influenced by individual differences, as well as situational limitations" (Kurtines, 1986, p. 790) and "pressures within companies are the best predictor for ethical or unethical behaviour" (Ferrelet al., 1985, p. 90). Therefore, the risk from adverse effects provoked by the lack of payment discipline is significantly increased in times of economic crisis (Official Journal of the European Union, 2011), and this is reflected in the decrease of investments, reduced trading volume and increased interest rates (Lin and Martin, 2010), and it is harder to obtain sufficient financial resources to ensure liquidity

(Vojinović et al., 2013). The directors of companies, who often justify unethical behaviour to themselves (Dean et al., 2010), e.g. a lack of payment discipline, have an important role in this issue. In addition, companies often derive no benefit from ethical behaviour (ibidem).

The lack of payment discipline, which is defined as late payments and debtors' failure to settle their liabilities (Commission of the European Communities, 2009), is a massive problem all European companies encounter, and it causes the greatest difficulties mostly among small and medium-sized companies. Managers are aware that the effect is greater if one euro is saved than if one additional euro is earned (Rottig et al., 2011), and companies with late payments save on interest payments, since, as a rule, late payments are a free source of financing. If late payments are actually intentional, according to 63% of companies (Intrum Justitia, 2011) then this is very unethical. Our assumption is that precisely the management of the company is responsible for this.

Many authors have confirmed the influence of management on the ethical behaviour of companies (e.g. Ferrelet et al., 1985; Posner et al., 1992; Wimbush et al. 1994; Kaptein, 2011; Hawkins et al., 2012; Boslaugh et al.,). If we observe payment discipline as a counter-norm, then the ethical behaviour of management should influence the payment discipline of the company. Therefore, we assumed that the ethics of the management influenced the timely or delayed settlement of the company's liabilities to suppliers.

The goal of this article is to determine if management ethics influences companies' financial discipline. The paper is structured as follows. After the introductory part of the paper, the second part of the paper explores the methodology of the research. Third part of the paper discusses results. Fourth part of the paper includes discussion. Finally managerial implications and conclusions are presented.

Methodology

Sample

Public and private companies with more than 10 employees were included in our survey. In the collection of companies listed in the database of the Slovenian rating agency "I d.o.o.", there were 2,978 companies eligible for our study. Our sample includes 273 Slovenian enterprises, which represented 9.1% of all the companies invited to take part in the survey.

Survey

An electronic questionnaire with a request to participate in an online survey was sent via email to the people responsible for accounting or financial data. The first part of the questionnaire, which also asked for the name of the company so that the data could later be compared with the data about its payment discipline, gathered information about the companies' management ethics, measured using ten statements from the Corporate Ethical Virtues measurement instrument (Kaptein, 2008). Translational equivalence was established using the back-translation process and conceptual and functional equivalence was confirmed by a team of experts in the field of business ethics. Average payment delay was calculated using the Dun & Bradstreet rating agency methodology (the average delay was calculated taking into account a sample of invoices). To avoid common method bias, the data concerning average late payments was not obtained from the respondents, rather it

was retrieved from the database of the Slovenian rating agency "I d.o.o." In order to minimise social bias, the survey was anonymous.

Statistical analysis

The acquired primary data were assessed and statistically analysed with Microsoft Office Excel 2003 and SPSS 20.0 (Statistical Package for the Social Sciences). Descriptive, factor, and regression statistical analysis was performed. Descriptive statistics of the sample and variables were computed and examined (e.g. arithmetic mean, variance, and standard deviation, standard error of the arithmetic mean, sample proportion, distribution frequency, and so on).

Results

We received 272 fully completed questionnaires; partially completed questionnaires were not included in the analysis. The share of companies with late payments is 64.6% and the average late payments 8.07 days. According to the company size there were 26.6 % micro, 35.1 % small, 18.1 % medium and 20.3 % large size companies. To study a link between the management ethics and the payment discipline, we include control variables that could also have an impact on payment discipline, i.e. liquidity measured with the short-term coefficient, structure of company's resources measured with the debt-financing rate, profitability of the company's business, measured with the coefficient of expanded profitability of resources, company size measured by the natural logarithm of the company's revenue, whether the company in the observed year had its transaction account frozen, the rate of competition in the industry, measured with the Hirschman-Herfindahl Index (HHI) and share of companies with frozen transaction accounts in the industry.

Factor analysis, reliability, and validity

Using factor analysis variability a potentially lower number of unobserved variables called factors is described. Bartlett's test was statistically significant ($\alpha = 0.000$) and the value of KMO test came to 0.712, which makes the data suitable for factor analysis. The construct "management ethics" ($\alpha = .956$) was analysed and confirmed with factor analysis. From the factor analysis, using the PAF method and varimax rotation, we get one factor, named "management ethics", which has an eigenvalue of greater than 1. Only one item was abandoned: "My supervisor fulfils his responsibilities". All of the items included in the factor explained 74.09% of the total variance.

Hypothesis testing

For testing the hypothesis, the stepwise method was used, which includes only statistical significant variables in the regression model. The results of the stepwise method are presented below.

Table 1
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.258 ^a	.067	.063	7.482
2	.310 ^b	.096	.089	7.378
3	.332 ^c	.111	.100	7.332
4	.352 ^d	.124	.111	7.289

Note: a. Predictors: (Constant), Freezing of the company's transaction account

b. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry

c. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry, Hirschman-Herfindahl Index (HHI)

d. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry, Hirschman-Herfindahl Index (HHI), Management ethics

Dependent Variable: Average payment delay to suppliers

Source: Author's illustration

The final regression model with 4 independent variables explains almost 11.1% of the variance of payment discipline. In addition, the standard error of the estimate has been reduced to 7.289, which means that at 95% the margin of errors for any predicted value of payment discipline can be calculated as $\pm \text{mean} + (1.96 \times 7.289)$. The four regression coefficients, plus the constraints are significant at 0.05.

Table 2
ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1072.798	1	1072.798	19.161	.000 ^a
	Residual	15004.669	268	55.988		
	Total	16077.467	269			
2	Regression	1543.302	2	771.651	14.176	.000 ^b
	Residual	14534.165	267	54.435		
	Total	16077.467	269			
3	Regression	1777.067	3	592.356	11.018	.000 ^c
	Residual	14300.400	266	53.761		
	Total	16077.467	269			
4	Regression	1996.493	4	499.123	9.393	.000 ^d
	Residual	14080.973	265	53.136		
	Total	16077.467	269			

Note: a. Predictors: (Constant), Freezing of the company's transaction account

b. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry

c. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry, Hirschman-Herfindahl Index (HHI)

d. Predictors: (Constant), Freezing of the company's transaction account, Share of companies with frozen accounts in the industry, Hirschman-Herfindahl Index (HHI), Management ethics

Dependent Variable: Average payment delay to suppliers

Source: Author's illustration

The ANOVA analysis provides the statistical test for overall model fit in terms of the F ratio. The total sum of squares (16,077.467) is the squared error that would accrue if the mean of management ethics has been used to predict the dependent variable. Using the values Freezing of the company's transaction account, Share of companies with frozen accounts in the industry, Hirschman-Herfindahl Index (HHI), and Management ethics, these errors can be reduced by 12.42% (1996.493/16077.467). This reduction is deemed statistically significant at 0.000. With the above analysis, it can be concluded that four variables, i.e. Freezing of the company's transaction account, Share of companies with blocked accounts in the industry, Hirschman-Herfindahl Index (HHI), and Management ethics, explain payment discipline.

Table 3
Results of regression analysis – stepwise method

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.170	1.314		1.651	.100
Freezing of the company's transaction account	5.432	1.340	.236	4.054	.000
Share of companies with frozen accounts in the industry	.302	.114	.156	2.656	.008
HHI	-.001	.000	-.135	-2.324	.021
Management ethics (H1)	-.914	.450	-.118	-2.032	.043

Source: Author's illustration

The hypothesis was supported because a statistically significant positive connection exists between payment discipline and management ethics ($\beta = -.118$, $p < .01$).

A significant positive relationship was observed between freezing of the company's transaction account and average late payment time ($\beta = .236$, $p < .001$) and share of companies with frozen accounts in the industry and average late payment time ($\beta = .156$, $p < .01$). A significant negative relationship was observed between HHI and average late payment time ($\beta = -.135$, $p < .05$) and management ethics and average late payment time ($\beta = -.118$, $p < .05$).

Discussion

With the factor analysis, we get one factor, which contains the variables of management ethics. The factor contains nine variables that are substantial in this set. The variable "My supervisor fulfils his responsibilities" was discarded due to the lack of communalities. Through regression analysis, we examined the relationship between management ethics and financial discipline. Using the stepwise method, we yield a model that is statistically significant, with which we explain 11.1 % of the variability of the dependent variable. The control variables Freezing of the company's transaction account, Share of companies with frozen accounts in industry, HHI and the variable Management ethics were included in the model and all of them have a statistically

significant impact. The results of the study supported the hypothesis. That is to say that the ethical behaviour of management has a positive impact on payment discipline. The companies, which had frozen transaction accounts, operate in industries with an increased share of companies with frozen accounts and in industries, for which the higher level of concentration (lower HHI) is significant, the companies are more likely to be late with payments.

The role of managers in creating an ethical working environment in a company is very important. They encounter different ethical dilemmas in their work and must be able to solve them successfully. Solving such complications is often difficult, since they are required to take decisions where they cannot refer to laws, regulations, statutes, and absolute truths. Namely, ethical dilemmas always cast doubts, and because of them, some people can be strongly affected or harmed. The consequences of unethical behaviour are often reflected in the loss of trust and goodwill. Loss of trust has a significant impact on the business operations of a company as it changes the attitude to work which in turn affects creativity, productivity, motivation and/or the workflow and climate in the company, which is also reflected in stunted communication and decreased commitment and loyalty. The loss of goodwill also has a high price, especially if the information about unethical behaviour is made public. Unethical behaviour can easily damage a reputation that was difficult to earn. The reputation of a company is built up over years, but can be destroyed in a single day by irresponsible behaviour (McAlister, 2003, p. 46; Tierney, 1997, pp. 18-34).

Conclusion

Considering the results of our research, we suggest the improvement of payment dimensions by creating an ethical working environment in a company. Taking into consideration these findings, it would be necessary to find appropriate forms of the incorporation of ethical behaviour-related training in business studies (in the cases in which such contents have not yet been included in curriculum). In this way, the moral judgement of future managers and financiers would be improved. In contrast, training with ethical content intended for current generations in management studies could be state-subsidised. First limitation of the research is geographic limitation, since sample of Slovenia enterprises was included in the study. Second limitation was that in the part in which we conducted a questionnaire, we interviewed only one person, and we assumed that we obtained answers showing the actual state of culture in companies. In the case of any research in the future, we propose comparisons between results obtained in different countries. Taking into consideration that there are considerable differences in payment discipline throughout Europe, any research on comparisons between the impacts of ethical climate and ethical culture in different countries with varying levels of payments discipline would be welcome. Within such research to be simultaneously conducted in more countries, it would be reasonable to verify the impact of national culture, defined as a "set of beliefs and values [that] distinguishes one nationality from the other and it is extremely stable" (Lažnjak, 2011, p. 1018), on payment discipline.

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