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An empirical evidence of ethical climate index in rural banks from Board of Directors Perspective

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ABSTRACT

The existence of the common image that the management of the rural bank is not yet professional because of some unethical practices are still happening. Rural bank that is well known for Indonesian people since its target markets are mostly in the rural area. The aim of the study is to investigate what are the most important factors that are reflecting ethical climate in rural banks. The study involves 153 directors of rural banks in Indonesia as respondents. Confirmatory factor analysis (CFA) was used to assess individual parameters in the model, feasibility and the statistical significance of the estimates parameter. The findings show that that ethical climate index is most reflected by collective moral sensitivity, but in contrary boards of directors in rural banks also recognize the lowest perception in this dimension. This would sense an urgency to fostering moral sensitivity among all hierarchies, from top management to the lowest levels in the rural banking.

ABSTRAK

Adanya kesamaan citra bahwa pengelolaan BPR belum profesional karena beberapa praktik tidak etis masih terjadi. BPR terkenal di masyarakat Indonesia karena target pasarnya sebagian besar di daerah pedesaan. Tujuan dari penelitian ini adalah untuk mengkaji faktor-faktor apa yang paling penting yang mencerminkan iklim etika di BPR. Studi ini melibatkan 153 direktur BPR di Indonesia sebagai responden. Analisis faktor konfirmatori (CFA) digunakan untuk menilai parameter individu dalam model, kelayakan dan signifikansi statistik dari parameter perkiraan. Temuan menunjukkan bahwa indeks iklim etis paling tercermin oleh sensitivitas moral kolektif, tetapi sebaliknya dewan direksi di BPR juga mengakui persepsi terendah dalam dimensi ini. Oleh karena itu, penting sekali untuk mendorong kepekaan moral di antara semua hierarki, dari manajemen puncak ke level terendah di BPR.

1. INTRODUCTION

Banks play a crucial role in the economy of a country, with more than 80 percent contribution to the financial market. Banks also play a crucial role to maintain financial stability. In a developing country such as Indonesia, there are several types of banks that enable people to choose which banking services they need (Harsono et al., 2017). One of them is the rural bank that is well known for Indonesian people since its target markets are mostly in the rural area. Rural banks are limited liability companies (the services that are offered by rural banking include deposit-taking, lending and placement to central bank or inter-banks, the other

services like deposits taking intocurrent accounts are prohibited. Mongid and Tahir, (2011) explain that shares are owned by the local residents with limitation where they are on the number of shares can be owned individually. These limits are placed as a mechanism control to avoid monopoly on the bank ownership.

There is a common image that the management of the rural bank is still not yet professional, because of some unethical practices or misconduct behavior at work. Generally, such unethical practices in the rural bank that identified are loan collection practices, exploitative credit application, and typical paternalistic of practices. Jasevičienė,

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(2012) also stressed that an important issue that is related to the ethics of bank include disobey the moral norms and ethics and practicing dishonesty.

In ethics studies, the ethical climate of an organization has gained attention as an influential primary factor of ethical behavior. It relates to how ethical issues should be addressed on a shared perception and the right ethical behavior. As an organization, it is assumed that individuals working in banking organization with its own social system such should have similar perceptions about their work's climate (Arnaud, 2006). Limited testing has been conducted on ethical climate's element with most of the evidence among employees as unit analysis (i.e., Vardi, 2001; Schminke et al., 2005; Arnaud, 2006; Arnaud, 2010). The ethical climate literature pays more attention to individuals or employees cluster emphasizing and their impact on the attitudinal mechanism (Suar and Khuntia, 2004; Shin, 2012). In this study, the ethical climate is defined and tested as a construct in the organizational-level that represents rural bank directors' perceptions of their firm's ethical climate. The present study is an attempt to analyze the factors that are reflecting ethical climate index and to investigate which is the most important factors that are reflecting ethical climate in rural banks. Our study could be the initial study to investigate banking directors' views toward ethical climate as corporate ethics, especially regarding rural banking in Indonesia.

2. THEORETICAL FRAMEWORK AND HYPOTHESES

Concept of Ethical Climate

The concept of ethics has been used as a tool to analyzed individuals' moral life in the daily activities. Ethical climate theory itself has been the subject of various studies for scholars for decades. The ethical climate introduced into the literature by Victor and Cullen (1988) is a part of the overall organizational climate. Tseng and Fan (2011) have argued that organizational climate is a way of representing individuals' feelings about a particular value of an organization, an authority system, and the motivation policies in a more practical way. While Martin and Cullen (2006) stated, ethical climate is a construct at organizational-level that represent shared perceptions of the employees of the policies, ethical practices, and procedures in their firm.

Parboteeah *et al.* (2010), defined ethical climate as the established organizational practices and processes to disclose what is right and what is wrong in organizations to describe the accepted and unaccepted behaviors. It is also defined as a judgment

on "what constitutes a proper behavior" and becomes a part of psychological mechanism that process the ethical issues (Martin and Cullen, 2006). Arnaud (2006) reviewed the theoretical development of an organizational climate in more elaborate manner, with three issues standing still, including how to describe, visualize mentally, and to do the construct measurement in particular. He argued that one suggested climate as a "shared set of conditions" while others suggested climate as a "shared set of perceptions".

Some of the previous scholars have suggested that perceptual agreement of individuals as part of a psychological construct was best describing organizational climate (Arnaud, 2006), in which this would lead to the understanding of organizational climate has arise as a result of the combination of similar climate perceptions at individual level.

Component of Ethical Climate

In many contexts, the concepts of morals or morality and ethics are perceived to be similar and go hand in hand. Victor and Cullen (1988) developed the Ethical Climate Questionnaire (ECQ) to measure participants' beliefs regarding their practice of ethical decision-making and ethical decision-making behaviors that is expected of their organization. A conceptual typology of ethical climate types by Victor and Cullen (1988) proposed based on two major dimensions below:

- Ethical criteria which include egoism, benevolence, principle that are used in decision-making process;
- The locus of analysis which include: cosmopolitan, individual, local.

Other ethical criteria used are based on three major classes of ethical theory:

- Egoism, this criterion focuses on self-interest maximization;
- Utilitarianism, this criterion emphasize on caring to mutual or group interests;
- Deontology which this criterion emphasize on the principles of moral.

As Arnaud (2006) stated that organizational climate emerged as a result of combining similar climate perceptions at individual level, we argued that ethical climate is a kind of shared and collective values or beliefs from individuals in the organization. This implies in various patterns of ethical climate dimensions across studies is expected. Theoretically, ethical climate construct has multiple dimensions. For instance Cullen, Victor and Bronson (1993) stated about nine types of theoretical ethical climates with two dimensions of ethical theory and

locus of analysis. Arnaud (2010) argued that the *Ethical Climate Index* (ECI) can be used as a reliable and valid tool to explain the content and strength of the prevalent ethical values, feelings, norms, behaviors, and attitudes of the individuals as part of a social system consisted of 4 factors, which are:

Collective moral sensitivity is defined as the prevalent norms that exist in a social system for both moral awareness and empathetic concern.

- Collective moral judgment is defined as “the norms of moral reasoning used to judge which course of action is morally right”
- Collective moral motivation is defined as “the prevalent values of the social system, and whether moral values such as honesty, fairness, or helping are generally prioritized over other values”
- Collective moral character is defined as “the norms for implementing a planned course of action”, which is also indicated by various factors such as self-control's norms and assuming responsibility's norms (Rest, 1986).

The conditions under which people work include personnel policies and procedures. From the literature review, Arnaud (2010) suggested that one of these four part of the decision-making process in ethical manner could be seen at the social system level as well. We identify the four basic dimensions of ethical climate to be tested and examined in this study.

From the literature review, we had a basis for predicting what the levels and variations in ethical climate dimension might be for the board of directors. Thus, we argued that based on Arnaud (2010) model of ethical climate that ethical climate dimension would be confirmed as an important and significant dimension.

3. RESEARCH METHOD

This research used survey design. The tool of measurement is developed based on the study discussed above. Ethical Climate Index was adapted in this study based on Arnaud's (2006, 2010) model, with its four dimensions as the initiator of the emergence of ethical behavior that consists of collective moral sensitivity, collective moral judgment, collective moral character, and collective moral motivation. In the current study, the evaluation of the measured constructs had been achieved by means of a 5 levels Likert scale, from “strongly disagree” (1) to “strongly agree” (5).

- Collective moral sensitivity was measured with a seven-item scale (sample item: “People around here are aware of ethical issues”).

- Collective moral judgment was measured with a six-item scale (sample item: “People around here protect their own interest above other considerations”).
- Collective moral motivation was measured with a six-item scale (sample item: “Generally people in our bank feel in control over the outcomes when making decisions that concern ethical issues”).
- Collective moral character was measured with a six-item scale (sample item: “achievement is valued more than commitment and loyalty”).

4. DATA ANALYSIS AND DISCUSSION

Based from descriptive analysis of the data, it can be seen that 38.5% of respondents were female, and were predominantly male (61.5% of respondents). About 11.1% percent of the population was in the below 30 age group, while 27.4% in the 31-39 age group, 31.1% in the 40-49 age group, and 30.4% in the 50 and older age group. About 37.8% were “outside” directors who were employed from external. The average age of the board of directors was 43.1 years, and their average tenure was 4.7 years.

As additional information, a one-sample t-test was performed to identify whether the sample for the present study had significant differences in their demographic categories related. In findings it can be found that there were no differences in the range source of career path (whether the board of directors is selected from inside or outside the organization) as well as wide range of their demographic characteristics (sex, ages, and educational background).

Among ethical climate dimension, show that the lowest mean is collective moral sensitivity and the highest one is a collective moral character. Confirmatory factor analysis (CFA) was used to assess individual parameters in the model, feasibility and the statistical significance of the estimates parameter. In assessing the whole model, the t statistic value was used to evaluate whether the factor is significant or not. Table 1 presents the results of the outer loadings, AVE, and composite reliability of the construct measured in this study.

Outer loadings among all of the constructs observed show that collective moral sensitivity, moral motivation, and moral judgment have value above 0.5 which this means a good concurrent validity is confirmed. It can also be concluded that not all constructs have loading factors that meet the criteria. There is a dimension of ethical climate index. It has a poor discriminant validity such as the collective

20 moral character. This measure should be higher than the shared variance between the construct of collective moral character in the ethical climate index model. Then, AVE value above 0.5 indicates sufficient discriminant validity. Convergent validity was used to indicate the degree of theoretically similar constructs whether they are highly correlat-

ed with each other. Meanwhile discriminant validity was used to indicate the degree to which a given construct is different from other constructs (Chin, 1998). The reliability of constructs value higher than 0.7, which this could assure accurate scale, means that the measures used in this study provide a satisfactory level of reliability.

	Means	Outer Loadings	Composite Reliability	Alpha Cronbach
1. Collective Moral Sensitivity	2.9195	0,847	0,869	0,799
2. Collective Moral Judgment	3.3284	0,674	0,839	0,655
3. Collective Moral Motivation	3.5790	0,729	0,814	0,679
4. Collective Moral Character	4.3087	0,295	0,837	0,738

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

As the board of directors in rural banks want all of their employees to not only work for profit maximization but also a greater benefit for stakeholders, they have to be more concern about ethical climate in their company. Board of directors must concern about collective moral sensitivity among individuals in their bank. Low moral sensitivity among employees in the rural bank is a pretty serious problem.

Results have revealed that the most important dimension of banking ethical climate index was reflected by collective moral sensitivity, but on the contrary, showing the lowest mean score. This could be indicated that low moral sensitivity among peoples who works in rural banks exist. Therefore, the collective moral character has the smallest coefficient in outer loading, but interestingly have highest average mean score compared with other ethical climate index dimension. The moral character does not always be a consideration in showing good ethical climate exist in an organization. This led to questioning why collective moral sensitivity is seemed to be impracticable in rural banks. Responsibility, fairness, and honesty are framework of three principal values that is important for a bank that need to measure ethical conduct. If a person come across a challenging situation, he/she can have a moral guidance about what would be the right choice, based on personal moral norms that is shared in the community or culture.

This study also proves that ethical climate index in rural banking practice would be better reflected by collective moral sensitivity and collective moral motivation. As empirical model also gives chance to the board of directors to gain a point of view in terms of measuring and evaluating the eth-

ical climate and fostering it more positively if necessary. These findings lead banking professionals to rationalize ethical behavior and decisions, and also it has important implications that suggest organizational efforts to improve the ethical climate by emphasizing the importance of corporate ethics that might reduce the prevalence of misconduct and fraud practices in banking business.

These findings have valuable suggestion for organizational behavior in an organization. The findings support that directors can protect the bank's interest by discouraging the firm from taking out an unethical practice that could increase the risks to the bank. Role models are present in the work environment; employees tend to emulate these models. Beside employees' supervisors and managers, the directors could serve as a significant role model.

1 The challenge at the managerial level is to coordinate the change of inputs into outputs namely products and services in a way that respects the stakeholders namely: owners, employees, customers, suppliers, the host community, and the natural environment. It only takes one unethical or illegal behavior to ruin an organization's reputation or result in damaging litigation. Schminke et al., (2005) argued that in the macro-level, employees would question their leader's ability to set and influence the ethical climate of the organizations. Also, under what conditions these influences might be strongest will be part of employees' consideration.

Two conclusions can be drawn from our discussion. First, the major endeavors of rural banking institutions should be refocused on fostering collective moral judgment and character among its individuals in the organization. Collective moral sensitivity founded as the most important dimension that reflected ethical climate in rural banking.

Therefore, as the board members realized that they have the lowest perception of collective moral sensitivity, it is a must for rural banks to increase it effectively. Second, insufficient convergent and discriminant validity of two dimensions means that ethical climate in rural banking was reflected only by collective moral sensitivity and collective moral motivation. This would lead to inconsistency findings in construct gap of ethical climate measured with psychological process model as proposed by Arnaud (2006, 2010).

There are several limitations to be addressed for the future research that is related with the current research. Relatively small samples collected in this study would be noticed as limitation. Another limitation was common method variance might be produced in this research as self-report measures which were used. Despite these limitations, this study provides an empirical base for further research. Future studies should be carried out to take into consideration a bigger sample, and also to examine outcomes of the ethical climate on board of directors' ethical attitudinal and behavioral mechanism. It is not just by knowing about how well they know about morality, but what will they do and how it will influence individuals' attitudes and overall organizational performance will be important to be analyzed.

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