The Total Mediating Effect of Corruption on the Relationship between the Code of Ethics and Corporate Performance: Case of Lebanon

By

Najib Bou Zakhem

A thesis
Submitted in partial fulfillment of the requirements for
the degree of Master of Business Law

Adnan Kassar School of Business
May 2016
THESIS APPROVAL FORM

Student Name: Najib Bou Zakhem  I.D. #: 201408602

Thesis Title: The Total Mediating Effect of Corruption on the Relationship Between the Code of Ethics and Corporal Performance: Case of Lebanon

Program: Master of Business Law (LL.M.)

Department: ITOM Department

School: Adnan Kassar School of Business

The undersigned certify that they have examined the final electronic copy of this thesis and approved it in Partial Fulfillment of the requirements for the degree of:

Master of Business Law in the major of Master of Business Law

Thesis Advisor's Name: Dr. Khodr Fakih | Signature: 11/5/2016

Committee Member's Name: Dr. Abdul-Nasser Kassar | Signature: 15/1/2016

Committee Member's Name: Dr. Abbas Tarhini | Signature: 11/5/2016
THESIS COPYRIGHT RELEASE FORM

LEBANESE AMERICAN UNIVERSITY NON-EXCLUSIVE DISTRIBUTION LICENSE

By signing and submitting this license, you (the author(s) or copyright owner) grants to Lebanese American University (LAU) the non-exclusive right to reproduce, translate (as defined below), and/or distribute your submission (including the abstract) worldwide in print and electronic format and in any medium, including but not limited to audio or video. You agree that LAU may, without changing the content, translate the submission to any medium or format for the purpose of preservation. You also agree that LAU may keep more than one copy of this submission for purposes of security, backup and preservation. You represent that the submission is your original work, and that you have the right to grant the rights contained in this license. You also represent that your submission does not, to the best of your knowledge, infringe upon anyone's copyright. If the submission contains material for which you do not hold copyright, you represent that you have obtained the unrestricted permission of the copyright owner to grant LAU the rights required by this license, and that such third-party owned material is clearly identified and acknowledged within the text or content of the submission. IF THE SUBMISSION IS BASED UPON WORK THAT HAS BEEN SPONSORED OR SUPPORTED BY AN AGENCY OR ORGANIZATION OTHER THAN LAU, YOU REPRESENT THAT YOU HAVE FULFILLED ANY RIGHT OF REVIEW OR OTHER OBLIGATIONS REQUIRED BY SUCH CONTRACT OR AGREEMENT. LAU will clearly identify your name(s) as the author(s) or owner(s) of the submission, and will not make any alteration, other than as allowed by this license, to your submission.

Name: Najiib Bou Zakhem
Signature: [redacted]
Date: 26/04/2016
PLAGIARISM POLICY COMPLIANCE STATEMENT

I certify that:

- I have read and understood LAU’s Plagiarism Policy.
- I understand that failure to comply with this Policy can lead to academic and disciplinary actions against me.
- This work is substantially my own, and to the extent that any part of this work is not my own I have indicated that by acknowledging its sources.

Name: Naiib Bou Zakhem
Signature: [redacted]
Date: 26/04/2016
Dedication

To my dearest parents,

Without your faith, patronage, and permanent encouragement I could never have done this work. Thank you for teaching me to believe in my infinite dreams.

This work is also dedicated to my instructors who did their best to lift me to the heights of a successful academic standing.
ACKNOWLEDGMENT

Many thanks to my advisor Dr. Khodr Fakih who established the bedrock of my project and to my committee members Dr. Abdul-Nasser Kassar who had the biggest contribution to the success of this study and Dr. Abbas Tarhini who offered support throughout this period.

Many thanks also to Ms. Sophie Lythreatis who provided assistance at the early stages of my work.
The Total Mediating Effect of Corruption on the Relationship between the Code of Ethics and Corporate Performance: Case of Lebanon

Najib Bou Zakhem

ABSTRACT

The code of ethics became a demanding concern for every corporation. Taking the case of Lebanon, the law does not require companies to adopt a code of ethics or any similar ethics program. Consequently companies tend to neglect the importance of the code on improving the quality of anti-corruption practices within the firm and the performance of the firm as a whole.

The purpose of this study is to examine the nature of the relationships existing among the three factors: code of ethics, perceived corruption, and corporate functioning. The study also aims to address the total mediating effect that perceived corruption plays in the relationship between the code of ethics and corporate performance. This quantitative study uses a questionnaire composed of thirty two questions administered and distributed among managers and employees working within SMEs in Lebanon. The PLS-SEM method using SmartPLS 3 software was implemented to analyze the data. The findings reveal that the direct effect of the code of ethics on performance is non-significant and suggest a strong negative relationship between the code of ethics and perceived corruption as well as between perceived corruption and corporate performance. These results also point out a total mediating effect for perceived corruption on the connection between the code of ethics and corporate performance.

Keywords: Code of Ethics, Corruption, Performance, SME, Mediating Effect, Ethics, Perceived Corruption.
# TABLE OF CONTENTS

I- Introduction.......................................................................................................................... 1  
1.1 Overview and Background................................................................................................. 1  
1.2 Need for the Study............................................................................................................. 2  
1.3 Research Objectives.......................................................................................................... 3  
1.4 Study Limitations.............................................................................................................. 3  

II- Literature Review............................................................................................................. 4  
2.1 Code of Ethics.................................................................................................................... 4  
  2.1.1 Definition of the Code of Ethics.................................................................................. 4  
  2.1.2 Reasons to Adopt a Code of Ethics........................................................................... 5  
  2.1.3 Content of the Code of Ethics.................................................................................. 10  
  2.1.4 Propagation of the Code of Ethics........................................................................... 13  
2.2 Code of Ethics, Corruption, and Performance................................................................. 19  
  2.2.1 COE and Performance............................................................................................. 19  
  2.2.2 COE and Corruption............................................................................................... 22  
  2.2.3 Corruption and Performance............................................................................... 24  

III- Hypotheses Development.................................................................................................. 26  

IV- Methodology.......................................................................................................................... 28  
4.1 Research Design................................................................................................................. 28  
4.2 Sample and Questionnaire.............................................................................................. 28  
4.3 Instrumentation.................................................................................................................. 32
LIST OF FIGURES

Figure 1: Common content of the code of ethics.......................................................... 13

Figure 2: Hypothetical Framework............................................................................. 27

Figure 3: Size of the firm......................................................................................... 34

Figure 4: Type of the business.................................................................................. 35

Figure 5: Change in sales......................................................................................... 36

Figure 6: Debt/Equity ratio....................................................................................... 37

Figure 7: The structural model.................................................................................. 42
LIST OF TABLES

Table 1: Corruption existence, forms, and perception at the corporate level........................................................................................................................................................................30

Table 2: Ethics standards and moral values existence and application at the corporate level..................................................................................................................................................31

Table 3: Size of the firm..........................................................................................................................................................................................33

Table 4: Type of the business..................................................................................................................................................................................35

Table 5: Change in sales.......................................................................................................................................................................................36

Table 6: Debt/Equity Ratio......................................................................................................................................................................................37

Table 7: Reliability..................................................................................................................................................................................................................................................38

Table 8: Rotated Component Matrix for corruption........................................................................................................................................39

Table 9: Component Transformation Matrix for corruption............................................................................................................................40

Table 10: Component Matrix for ethics.................................................................................................................................................................41
Table 11: Rotated Component Matrix for ethics.................................................41

Table 12: Structural Model coefficient, standard error, t-statistics,

and p-values......................................................................................................43

Table 13: The administered survey.................................................................63
LIST OF ABBREVIATIONS

AICPA  American Institute for Certified Public Accountants
CG    Corporate Governance
CIMA  Chartered Institute of Management Accountants
COE   Code of Ethics
COI   Conflict of Interest
EAV   Economic Added Value
ISF   Internal Security Forces
IT    Information Technology
LTA   Lebanese Transparency Association
NYSE  New York Stock Exchange
OECD  Organization for Economic Cooperation and Development
P/E   Price Earnings Ratio
SME   Small/Medium-sized Enterprise
SOX   Sarbanes-Oxley Act
Chapter One

Introduction

This division comprises a general idea of the study by showing the importance of the COEs at the corporate level, the need for undertaking this study, the research problem to be examined, the research objectives, as well as the study limitations.

1.1 Overview

Codes of ethics acquired a greater importance worldwide, especially in the early 90s as companies became more sensitive to the International Human Rights standards such as those related to the International Labor Organization (“Code of Ethics & Whistle Blower Procedure for SMEs”, 2009). This increasing significance in the code of ethics is also affected by the companies’ concern to demonstrate an effective ethics compliance program, to abide by certain legislative acts such as the SOX of 2002 in the U.S. (Schwartz, 2004) and to create an ethical culture within the organization (Weiss, 1994). Studies have shown that companies with a better financial performance are those which are committed to certain ethics standards and other ethics programs (Verschoor, 1998; Donker, Poff, & Zahir, 2008). Moreover, codes of ethics became very necessary as the world is undergoing very rapid changes and dramatic technological improvements. As a result, IT corruption issues became more prevalent worldwide in the absence of
controlling legislative acts and ethics related standards in a large number of countries especially in the developing ones.

1.2 Need for the Study

The code of ethics became a cardinal document for the most successful corporations in the world. However, the Lebanese SMEs generally tend to disregard the prominence and the influence of the code on reducing the level of perversity within the firm and consolidating its financial gain. This is due to the fact that Lebanon does not legally enforce any type of business operating in the area to establish or follow a code of ethics or any similar ethics driven document.

Moreover, many studies worldwide intended to study the relationship existing between the code of ethics and corporate performance (Friedman, 2007; Ferrel & Fraedrich, 2014; Morris, 1997; Chun et als, 2013), the connection between ethics and corruption (Eiras, 2003; DeLeon, 1993, Lawton, Wal, & Huberts, 2015; Engels, 2009) and the linkage between corruption and corporate performance (Vannoni, 2014, Zekos, 2004; Abrate et al, 2013).

However, none of the studies aimed to examine yet the interceding function that corruption plays between the COE and the functioning of the enterprise. Here comes the importance of this study which aims to prove the interceding function of corruption on the linkage between COE and the firm’s financial outcome and takes Lebanon as a particular case due to the fact that a considerable number of enterprises in Lebanon
(mainly SMEs) try to neglect the importance of the COE as the adoption of this code is not legally required.

1.3 Research Objectives

As previously mentioned, this study aims to examine the type of the linkage existing between the COE and corporate performance, COE and corruption, as well as corruption and performance. It also intends to test the mediating effect that corruption plays in the connection between the COE and the firm’s productivity.

1.4 Study Limitations

Although the paper was able to prove the deduced hypotheses, it encountered a number of limitations and shortcomings. First, due to the time limit, the questionnaire was conducted on a small number of participants with a total of 105. As a consequence, the results of this study are merely related to this sample size which could not be enough to generalize the deduced conclusions. Second, the majority of the managers and employees surveyed were located in the capital Beirut. In this sense, employees and managers working at SMEs outside the capital did not have the opportunity to contribute to the delivered results. Finally, although the survey is totally confidential and the participant is provided with the right to withdraw at any time, a number of employees and managers declined to participate in the survey due to the subject’s sensitivity.
Chapter Two

Literature Review

2.1 Code of Ethics

This section includes the definition for COE, reasons to adopt a COE, content of the COE and the propagation of the COE.

2.1.1 Definition of COE

Prospectors have different viewpoints of what the code of ethics is, especially in the early and mid-90s when a large number of corporations in the U.S. and Britain recognized the importance of the COE. Codes of ethics also have different names such as corporate credos, value statements, and codes of practice (Withers & Ebrahimpour, 2013).

Singh (2015) provides a comprehensive definition for the code of ethics as an ethical program implemented for the purpose of creating an ethical culture in the corporation. However, it should be noted that the researchers’ concern with the definition and the interpretation of the COE is not recent. For instance, Stevens (1994) and Hosmer & Hosmer (1991) define the COE as a document including moral principles and standards that lead and direct the demeanor of the employees and such document must be formal
and written. Similarly, Langlois & Schlegelmitch (1990) view the code as a statement consisting of maxims, conduct rules and the company’s philosophy concerning its obligations and responsibilities to the different stakeholders, such as consumers, employees and the society as a whole. Moreover, White & Montgomery (1980) proclaim that the code deals with matters that are not covered by the law or in other words the issues that are not imposed by the law. Hence, this means that the code of ethics includes standards governing the employees’ conduct. This is what Schwartz (2002) stated in his article “A Code of Ethics for Corporate Code of Ethics”.

Other researchers were more general in their definition, such as Weller (1988) who argues that the COE is a group of policies which are set as a reference for the current and future practices. Further, Forcese (1977) views the code as a group of principles that the business voluntarily agrees to apply in its functioning. In this sense, the code of ethics is established for the purpose of sustaining and enhancing the ethical culture in the organization.

2.1.2 Reasons to adopt a COE

Although it is generally agreed on that the code of ethics is primarily founded for the development of an ethical culture in the organization (Singh, 2015), prospectors provide different arguments regarding the purposes and the reasons that urge companies to adopt a COE and analyze its functions using different approaches.
Some of them view the code from a purely ethical perspective. Weiss (1994) affirms that the code is created for the purpose of placing the morals of the company’s management within an organizational context. Additionally, Nygaard & Russo (2008) view the code as a way to create a trust state. Moreover, Singh (2011) vouches that the code is used to face the ethical problems in the business world. Besides, Wotruba, Chonko, & Loe (2001) emphasize that codes of ethics serve three main goals in the corporation; they show the extent to which the organization takes into account ethics in its activities, convey the organization’s ethics to the employees and influence the employees to follow such expectations which target their behavior. This means that creating a code of ethics is a fundamental method to reflect the organization’s desire of creating an employee’s ethical climate. Moreover, Wotruba, Chonko, & Loe (2001) assert that the code provides an efficient way to help employees address the ethical problems that the organization faces and understand its core values and morals.

In addition, it is necessary to influence the employees in order to follow the established behavioral expectations. According to Trevino (1990), this can be achieved by making such codes of ethics enforceable. This is also recently stated by Shaw & Barry (2015) who consider that codes of ethics are created for the purpose of improving the overall climate of the organization which indirectly affects the conduct of the individuals. Finally, Kaptein (2011) & Singh (2011) likewise claim that codes are established for a purpose of reducing the unethical acts in the organization.
However, other researchers discuss the reasons behind the creation of the COE from a managerial view. For instance, Davidson & Stevens (2012) explain that the code is espoused for the aim of ameliorating the doings of the top management and the trust of the investors in the company. Stevens (1994) professes that the code of ethics is a “message” delivered by the organization in order to deflect criminal charges and to avoid the perpetration of crimes by the employees, or a means not only to create prudent individuals, but also creditworthy organizations (Wood, 2000). Furthermore, Adams, Tashchian, & Shore (2001) emphasizes that the COE is a managerial and legal tool to protect the corporation from the employees’ unethical and illegal practices. Alongside, Snell et al (1996) exclaim that the code is an “en garde” strategy or a systematic program with a purpose of protecting the firm against wrong practices (Lefebvre & Singh, 1992).

On the contrary, other prospectors have a different argument. Cressey & Moore (1983) regard the code from a financial perspective and contend that the main initiative behind the establishment of the code is to preserve profits and build trust with the clients. However, Ferrell & Fraedrich (2016) conceive the code from a legal perspective as a tactic to avoid legal problems, or a tool which is created to fill the legal system’s gap regarding the morality of the corporate decisions (Arrow, 1974; Stone, 1975). According to Schwartz (2004), the code is viewed as a method followed in order to comply with certain legislative developments. Examples of legislative acts in this concern include NYSE requirements and the SOX of 2002 which enforces the disclosure by publicly held companies.
Besides, McDonald (2009) summarizes seven major reasons that urge companies to implement and adopt a code of ethics. These reasons are (1) to ameliorate the reputation of the firm (2) to ensure that the company is abiding by the legal requirements (3) to provide a reference for the behavior (4) to ensure that different stakeholders are complying with the company’s rules and principles (5) to establish a strong relationship with the stakeholders (6) to minimize risks (7) to pursue the world’s needs.

Nevertheless, the usage of the codes cannot be limited to these seven main reasons because the code’s usage is directly correlated to the size of the firm (Sweeny & Siers, 1990), and the code is also affected by other corporate variables. For example, Weaver (1993) propounds that the changes in the circumstances within the organization, the management, and the society as a whole affect the functions that the code delivers.

The functions and the roles of the code of ethics can be also grouped as intentional, operative vs. espoused and unintentional (Weaver, 1993).

From an intentional perspective, the adoption of the code by the firms is considered an ethical step by itself (Brothers, 1991). Codes from this perspective can also be created to establish certain values that the practitioners are recommended or obliged to pursue in order to lessen the harm on the society as much as possible (Francis & Dugger, 2014) or to satisfy the expectations of the different stakeholders related to the firm (Weaver,
In this sense, codes provide an opportunity to address certain ethical and social issues that the firm might encounter, such as social welfare, discrimination, etc… Codes also provide an opportunity to manage organizational internal issues (Brothers, 1991), such as the hierarchy issues, organizational structure, and so forth. Within the same perspective, Pfeffer (1981) proclaims that the code provides efficient tools allowing the management to make the acts performed by the corporate members rational.

From an operative vs. espoused perspective, Meyer & Rowan (1977) avouch that in certain cases the internal duties and tasks performed in the firm do not match with the code and its standards.

From an unintentional perspective, Abrahamson (1991) avers that some firms adopt a code of ethics just because it became a managerial trend, not taking into account the actual functions that the code serves. In this sense, firms implement the code for the mere purpose of imitating large and reputable companies. Last, with reference to a Conference Board study conducted in 1990 on international business ethics activities, the imperativeness of nongovernmental organizations and the internationalization of large businesses are the main reasons that inspire companies worldwide to develop ethical codes and other ethics programs.

Despite the several reasons behind the establishment of the COE, studies are not consistent regarding the effectiveness and the efficiency of such codes. In an empirical study regarding code effectiveness and their impact on employee behavior, Ford, Gray,
& Landrum (1982) avouch that codes of ethics are ineffective. Besides, Wood (2015) professes that the presence of a COE does not assure that the employees will manifest an ethical behavior, and Mathews (1998) warrants that there is only a little correlation between the COEs and organizational violations.

### 2.1.3 Content of the COE

This wide variety in the reasons that urge companies to adopt a COE is affected by the code’s content. Content-oriented studies are concerned with the composition of the code and the organization of its content (Lugli et al, 2009; Kaptein, 2004). Since there are no specific or standardized issues to be addressed in the code, codes range from very general to lengthy detailed sets of rules and regulations. Respectively, the structure of the COE was the concern of many contributors in order to allow more apprehension of this document (Lugli, Kocollari, Nigrisoli, 2009; Moffeit, O’Malley, & McCraw 2008).

Moreover, the COE content was a rich discussion since the early years. Manley (1991) and Berenbeim (1987) negotiate that codes of ethics have different structures including a succession of possible events, question/answer structure, or lists (Manley, 1991; Berenbeim, 1987). According to Bellah (1992), the code generally addresses tangible issues (e.g., avoiding contamination, caring for charity actions…) more than intangible company issues. Weaver (1993) argues that the content of the code changes as it is strongly influenced by the legal conditions, managerial determinations, and the social ambiance.
Other researchers discuss the content of the code deeply. For instance, Carasco & Singh (2003) avow that the code’s content is grouped into seven broad categories. The first category focuses on the deportment (e.g., relations with customers, relations with employees, relations with suppliers, bribes policy...). The second category encompasses the behavior against the organization’s interests (e.g., COI). The third one includes the moral soundness of the books and records (e.g., external audits, independent audits, etc.). The fourth comprises of the basis of the code (e.g., legal responsibility). The fifth covers references to specific laws and regulations (e.g., competition/anti-trust, securities, etc.). The sixth comprehends compliance (e.g., internal audits, review of financial statements, internal watchdog committee, etc.). Finally, the seventh involves general information (e.g., preserving a good reputation). Similarly, Schwartz (2000) suggests six sets of standards that the code must address. These moral standards are trustworthiness, respect, citizenship, fairness, and caring. He also argues that the code must be inclusive in order to make companies legally responsible for their actions and assures that the moral principles listed in the code should be rational and should precede any other corporate objectives such as profits.

Although some commentators recommend a list of subjects to be addressed in the code of ethics (Hancock, 1995; Driscoll et al., 1995), it is difficult to provide a model list because each company has its unique characteristics that affect the topics that the code will encompass, and the company must ensure that the code provisions are practical and
achievable (Schwartz, 2002). Weaver (1993) provides an ideal list of issues that are generally included the code of ethics (Figure 1).

In addition, some experts predicate that the areas of discussion of the COE are not fixed. Singh (2015) warrants that the content of the code changes depending on a number of company-related variables and that it is important to make the code and its content a realistic and extant document in the organization in order to attain its purpose.

Finally, the tone also plays a fundamental function in delivering the “message” of the COE. Schwartz (2000) avouches that the negative tone in the code of ethics shows an ambiguous and straight direction which can be easily construed, but the use of a positive tone in the code is not advocated in certain cases, especially with issues related to totally unaccepted behaviors in the firm, such as bribes and gifts.
### General Matters Pertaining to the Code
- Purpose of the code
- Context of the code
- Code history and development; supporting programs
  - Firm history and traditions
  - Market/societal conditions
- Administration of the code; compliance measures; sanctions
- Authority of code (firm or individual self-interest; firm traditions; ethical principles; legal requirements).

### Employee Issues
- Employee/company responsibilities to each other
- Expectations for employee self-development
- Substance abuse; employee health
- Rights of employees (e.g., privacy, termination issues)
- Harassment, intimidation, etc.
- Employee political activities
- Workplace safety, quality (e.g., smoking policies)
- Conflicts of interest, nepotism
- Standards for judging salary & benefits
- “Moonlighting” and other external activities
- Contact with media
- Whistle-blowing
- Use of company equipment, supplies, good name, etc.
- Use of proprietary information (e.g., intellectual property)
- Use of confidential information (e.g., insider trading)
- Use of computer information systems
- Security and espionage
- Relationships with government agencies and officials
- Policies on gifts, entertainment, travel, etc.
- Bribery, kickbacks, etc.

### Firm’s Status and Actions in the Market
- Firm reputation and integrity
- Competition, treatment of competitors
- Purchasing, sales, and negotiating policies
- Product safety and quality
- Marketing practices, advertising (e.g., honesty)

### Responsibilities to Society
- Community and charitable activities
- Environmental protection, hazardous wastes, energy use
- Public safety and education
- Support for a political/economic system (e.g., free markets)

### Legal Matters
- Compliance with law (e.g., antitrust, non-discrimination, OSHA, etc.)
- Avoid regulation

---

**Figure 1: Common Content of the COE**

### 2.1.4 Propagation of the COE

Countries recognized the significance of the code of ethics through different time periods depending on their level of development. It is worthwhile noting that some countries, the developing ones in particular, did not perceive yet the positive influence of the COEs.
The United States of America was at the forefront of the countries which recognized the importance of the code. With reference to a study conducted on international business ethics by the AICPA and the CIMA, 80% of the respondents showed that their firm has a COE or other ethics driven paper, and 57% of the respondents stated that their firm organizes ethics training sessions (Eyden, 2012).

Although U.S.A was one of the first countries to realize the importance of the code of ethics, prospectors have different opinions regarding the time period during which the adoption of the code of ethics has been intensified, knowing that USA does not have a securities law that imposes companies to implement a COE. In this context, some researchers swan that the concerns with corporate COE in the U.S. have intensified in the 1990s. Oliverio (1989) sustains his statement by the example of Johnson & Johnson who uprose their own ethics statement in the 1940s. However, Benson (1989) & DeGeorge (1987) ascertain that codes began to gain attraction in the United States since the 1960s.

In U.K, the recognition of the importance of the COE is not recent as in 1989 Schlegelmilch & Houston examined two hundred of the large listed companies in Britain and found that the code is present among 42% of them.
In Italy, the legislative decree 231/2001 recommends companies to create a “model” to avoid the commission of crimes and states that this “model” is not obligatory but is strongly recommended as its adoption limits the involvement of the company and its employees with fraudulent and criminal actions.

However in Lebanon, the law doesn’t require companies to embrace a COE or any kind of ethics policy. Although, the Lebanese Code of Commerce implicitly covers one of the major issues that the code of ethics governs.

Article 86 of the Lebanese Code of Commerce (1942) concerning the Joint Stock Companies states that one or more experts are to be appointed by the court in order to ensure the “accuracy of evaluation of contributions” of the firm. This reconciles with one of the major issues to be addressed in the code of ethics which is the transparent recordkeeping practices (Weaver, 1993).

Moreover, some organizations in Lebanon realized the significance of the COEs and took certain attempts in this context. For instance, the Lebanese Transparency Association published through the Anti-Bribery Network a Code of Ethics & Whistle Blower Procedure a study for SMEs recommending SMEs in Lebanon to adapt themselves to certain ethical standards through the COE (“Code of Ethics & Whistle Blower Procedure for SMEs”, 2009). This study showed the procedures to be followed
in order to draft the code and classified the major issues that the code would target (e.g., all employees should act for the mere interest of the company). This program, initiated by the LTA, did not have a big chance to be spread among SMEs in Lebanon and did not have any binding effect on the firms.

Furthermore, the Lebanese public sector in the recent years was also involved in spotlighting the significance of the COEs. In 2008, UNESCO Regional Office in Beirut launched in collaboration with the National Media Council the “Bill of Media and Professional Ethics” proposal which included ethics rules and guidelines for the media work (Chahine, 2009). This draft did not enter into force as it did not obtain the approval of the Council of Ministers. In addition, the Ministry of Information in Lebanon declared in March 2009 ten voluntary principles related to the Media profession ethics (Chahine, 2009).

Again, in 2011 the Directorate General of Internal Security Forces drafted a “Code of Conduct for the Internal Security Forces elements” which included a big section covering the legal and ethical standards that the Internal Forces must adhere to while performing their duties (“Code of Conduct for ISF”, 2011).

It is also necessary to shed light on the information security crimes issues and the minor attempts taken by the Lebanese legislative and relate such issues to the code of ethics. In
fact, the Lebanese Law took a number of endeavors to maintain the intellectual property and other information technology related rights, but these attempts are not enough due to the lack of an enforceable IT code of ethics, e-crimes laws and regulations, computer-related policies and other IT ethics training programs.

The legislative and jurisprudential efforts taken by the Lebanese regulatory and legal bodies concerning IT standards and ethical principles are due to the increase in the cybercrimes taking place in Lebanon and having two different forms: (1) délinquance non-informatique which means the crimes that are committed through the use of informatics (traditional criminal acts) and (2) délinquance informatique which takes place when the crime and information usage occur simultaneously (new criminal acts) (Rizk, 2009).

There were many attempts by the legislative bodies in Lebanon for the establishment of an integrated law in this sense.

In 2002, the Ministry of Economy and Trade realized the significance of e-commerce through “Ecomleb”. Ecomleb is a project funded by the Eurpoean Union and took the responsibility to develop a complete legal framework for e-commerce in Lebanon addressing the following areas: data protection and privacy, electronic writings and digital signatures, electronic communication, online contracts and burden of proof, cybercrimes, intellectual property rights and electronic contracts. Yet, this bill did not have the opportunity of being discussed by the Lebanese parliament (“Previous
Projects”, n.d.). Similarly, during the period between 18/08/2005 and 22/12/2006 the IT Parliamentary Committee discussed a thorough “Information Technology” law proposal which did not attain the governor’s signature (Rizk, 2009).

However, even in the absence of an integrated legislative act regarding information technology securities, a number of traditional provisions can be found applicable as well as recent texts.

Article 733 of the Lebanese Penal Code on sabotage and perturbation punishes every person who intentionally devastates something owned by another person (Lebanese Penal Code, 1943) and it is applied to the informatics policies by the Lebanese Judiciary (Rizk, 2009).

Similarly, articles 635 (on theft), 650 (on blackmail), 655 (on fraud) and 714 (on unlawful competition) are also applied by the Lebanese Judiciary on cybercrime cases.

In addition, article 40 of the Patent Law imposes punishments on the infringement of patent rights (Lebanese Penal Law, 2000). Add, articles 85 and 86 of the Literary and Artistic Property Protection Law in Lebanon state that a person is held liable if he intends to fraudulently possess, violate, use, imitate, or infringe a copyright or related rights provided by this law (Law on the Protection of Literary and Artistic Property, 1999).
Despite the presence of various law provisions controlling information security and cybercrimes, it is necessary to have an organized code of conduct as a rational and realistic protection method associated with the Lebanese legislative acts in order to make the different parties more responsible and involved and to lessen the cases of cybercrimes in Lebanon (“Round table to discuss 'the protection of children in cyberspace’”, n.d.).

### 2.2 Code of Ethics, Corruption, and Performance

This section reviews the relationship between COE and Performance, COE and Corruption and Corruption and Performance.

#### 2.2.1 COE and Performance

It is extremely important to study the financial outcome of the enterprise and associate it to the COE since one of the major responsibilities of the firm is to increase profits (Friedman, 2007).

The connection between the COE and the performance was the concern of many analysts throughout the years who either found a positive, negative, or neutral linkage between COE and profits.
A big number of investigators asseverate that a proportional linkage exists between the financial and ethical performance of the firms. Ferrell and Fraedrich (2014) state in their study on business ethics that the ethical businesses are the most profitable ones. Chun et al. (2013) also assure the contribution of ethics derived from the code to the corporate performance.

This relationship between the COE and performance was also a fruitful discussion by many researchers since the early years. For example, Morris (1997) demonstrates that the corporate societal functioning is shaped by the ethical standards of the business. Verschoor (1998) statistically emphasizes that there is a positive relationship between the strong allegiance to ethics programs by the management and the firm’s financial outcome. Similarly, and after the analysis of the organizational culture within 10 firms, Heskett and Kotter (1992) ascertain that the firm’s performance is basically affected by its cultural development. Likewise, Wu (2002) ensures that a higher level of ethical practices (i.e. code of ethics) in the firm leads to a better decision-making. Alongside, Donker, Poff, & Zahir (2008) sustain this idea by numerically proving that the corporate ethical standards and the firm’s operations are directly proportional since the effectuation of concrete business ethics practices in the daily activities of the firm leads to better interaction between the management and the organization as a whole. In addition, Spencer & Taylor (1987) insist that corporate ethics-oriented standards and profitability are coincidental, and this notion was also affirmed by Waddock & Graves (1997) as well as Roman, Hayibor, & Agle (1999).
Other researchers determined the linkage between the COE and performance using purely financial tools and measures. For example, after surveying and testing a number of the largest companies in U.K., Webley & More (2003) underpin the idea that a positive correlation is present between the code of ethics and organizational performance by showing that U.K. companies adopting a code of ethics have a higher EAV than those without a code. They also argue that companies with a code have a lower P/E ratio meaning that such companies have an invulnerable investment than the businesses which do not adopt a COE or any other similar document.

Finally, some researchers see an indirect relationship between the COE and the organizational performance, such as Hosmer (1987) who claims that the competitive position of the firm is strongly influenced by the firm’s strategic planning.

On the contrary, a minority of researchers negate any connection which might exist between the COE and the organizational performance or affirm that the unethical behavior sometimes enhances the company’s financial outcome. For instance, Cummings (2000) reasons that there is neither a positive nor a negative relationship between the code and the performance at the level of the Australian firms. This is reinforced by Coffey & Fryxell (1991) as well as McGuire, Sundgren, and Schneeweiss (1988) who find that there is no connection between business ethics and performance. However, Ferrell and Fraedrich (1991) contend that sometimes the unethical behavior or
the behavior that is not aligned with the firm’s ethics principles has to be accepted by the firm to save itself under certain conditions and circumstances.

2.2.2 COE and Corruption

This section will define corruption and highlight the relationship between the COE and corruption.

Corruption is viewed as an unethical act (Eiras, 2003) or a practice having a bad influence on the social wellbeing (Zekos, 2004). It can be also viewed as an action done for the purpose of achieving personal gain without being sanctioned (DeLeon 1993). However, Johnston (2005) asseverates that corruption is defined in accordance to its backdrop as its understanding is based on many different variables and it changes among societies, groups, and individuals.

COE and corruption have increasingly been the discussion of many corporate governance researchers in the world, especially after the 1990s.

The majority of researchers ascertain that businesses with ethics driven standards and corruption contradict each other. Garofalo et al (2001) accentuate that corruption is solely an ethical and legal problem which is prohibited by the establishment of principles that primarily concentrate on the improvement of the employees’ character. They also proclaim that the anti-corruption programs, such as the OECD initiative on
financial management are important, but not sufficient to prohibit corruption because such initiatives must address the basic interests of the firm. Garofalo et al (2001) also provide anti-corruption reforms accountability, ethics training, as well as value-based management.

Moreover, Eiras (2003) predicates that individuals are the main cause of corruption. He also proves that the unethical behavior of individuals is affected by the culture in which the individuals live and work, and that this is facilitated by either the absence or the weak application of law. Crocombe (2001) also confirms that there is a number of reasons that lead to corruption, such as the lack of ethics attributes among people which can be addressed by the COE and the intemperance of assentient action policies.

Researchers are not only concerned with the study of the relationship between the COE and corruption, but also with the analysis of the optimal solutions that might prohibit or lessen the corruptive practices within organizations. For instance, Eiras (2003) provides a solution from a purely legal perspective by applying specific laws and eliminating unnecessary overregulations to avoid the unethical behavior. However, Dramer (1997) assures from an ethical perspective that corruption reforms can be attained through the creation and development of certain character virtues such as commitment and honesty. These character virtues can be developed through the implementation of ethics driven programs such as the COE.
On the contrary, Lawton, Wal, & Huberts (2015) avow that ethical behavior and corruption cannot be viewed as a single phenomenon as they vary depending on time, cultures and geography. From this side Engels (2009) also views that corruption can be assessed according to the value framework of the time at which corruption has been examined. In addition, Lloyd (1993) argues that in some cultures certain forms of “corruption” are accepted such as gifts, dinners, etc, while in other cultures they are rejected. Add, Szeftel (1998) assures that corruption in certain times is not negative and it is a solution to “cut red tape”.

2.2.3 Corruption and Performance

Many studies worldwide sought to examine the influence of corruption (especially bribery) on the firms’ output through the use of quantitative estimates and qualitative analyses.

Recently, Vannoni (2014) shows that corruption tampers the efforts of the management and accordingly consolidates the corporate inefficiency. Moreover, Abrate et al (2013) sustain the idea that economic benefits can be achieved through the implementation of anti-corruption policies as well as pro-accountability programs.

However, testing the corruption-performance model is not very recent as since the early years almost all prospectors agree that corruption has a direct influence on the financial performance and economic growth. Through an empirical study on African firms,
McArthur & Teal (2002) conclude that corruption is a fundamental determinant of the African firms’ performance and that firms working in an economy free of bribes and other forms of corporate corruption are 66% more productive than firms operating in a corruptive environment. Vishny & Shleifer (1993) also see that corruption creates a state of uncertainty regarding profits and productivity within the firm and consequently threatens the entrepreneurs trust and confidence toward the firm.

Furthermore, Tanzi & Davoodi (1997) swan that companies which seek to restrain corruption have a greater competitive advantage over other companies within the same industry. Zekos (2004) also avers that the quality of the services provided by a firm are negatively affected by the firm’s corrupt circumferent and Mauro (1995) statistically proves that there is a negative association between corruption and growth.

On the contrary, a minority of economists agree that corruption might have a positive influence on the financial position of the company. For example, En et al (2015) conducted a study on 484 Chinese firms and deduced that the firm’s performance is enhanced by its compliance to corruption, not by its resistance. Choi & Woo (2010) also see a positive linkage between corruption and the economic output, as well as Lloyd (1993) who views gifts, dinners and other forms of “bribery” as acceptable in many cultures and not a form of corruption.
Chapter Three

Hypotheses Development

Although a big number of investigators assert a direct positive linkage between ethics and corporate performance such as Ferrell and Fraedrich (2014) and Chun et als (2013), however, Cummings (2000) as well as Coffey and Fryxell (1991) avow that there is neither a positive nor a negative connection between the COE and the performance of the firms. Subsequently, the first hypothesis is as follows:

\[ H_1: \text{There is a relationship between the COE and corporate performance.} \]

Further, Michael, Carr, & Bowser (2015) accentuate that ethics and corruption contradict each other. This is also affirmed by Garofalo (2001), Eiras (2003), Crocombe (2001), and Dramer (1997). For this reason, the subsequent hypothesis is developed:

\[ H_2: \text{There is a negative relationship between COE and corruption.} \]

Vannoni (2014) affirms that corruption consolidates the corporate inefficiency. This is also sustained by Abrate et al (2013) who consider that financial benefits can be
achieved through the adoption of anti-corruption programs and policies. Consequently, the following hypothesis is formulated:

\[ H_3: \text{There is a negative relationship between corruption and corporate performance.} \]

Thus, these three hypotheses (H₁), (H₂) and (H₃) add up to formulate the fourth hypothesis:

\[ H_4: \text{Corruption plays a total mediating role in the relationship between the COE and corporate performance.} \]

The hypotheses model is developed in Figure 2.

---

**Figure 2: Hypothetical Framework**
Chapter Four

Methodology

This research is set out to examine the level of corporate performance at SMEs in Lebanon, to test the managers’ and employees’ perception regarding the existence and application of ethical practices within these firms and to detect the corruption level at the top management and employees’ level. The purpose behind studying these three variables is to examine the total mediating role that corruption plays in the correlation between the COE and performance at the level of Lebanese SMEs.

4.1 Research Design

The study has a quantitative nature as a questionnaire is designed and administered, and its results are measured numerically and then analyzed.

It refers to a cross-sectional analysis (prevalence study) since data is collected through a one-time contact with the respondents.

4.2 Sample and Questionnaire

A self-administered questionnaire is carried out in person and composed of three main sets of questions. The complete questionnaire can be referred to in Appendix “A”.

28
The first section involved four questions measuring demographics (size of the firm, nature of the business, average sales revenue, and debt/equity ratio) and the two latter questions are also used to measure the performance of the firm. This section followed the Choice Determinant Structure.

The second set of questions followed the Likert 5 point Scale (ranging from Strongly Disagree SD to Strongly Agree SA) and aimed to quantify the level of corruption in the firm with reference to the “Enterprise Survey” conducted by the World Bank (“Enterprise Survey Data”, n.d.) (Table 1).

The Third set of questions also followed the Likert 5 point Scale and intended to ask the respondents about their perception, commitment, presence and efficiency of ethics standards and moral values within the firm with reference to a questionnaire developed to study the impact of ethics on CG. (El-Kassar, Messarra, Elgammal, 2015) (Table 2).

The questionnaire targeted 105 participants arbitrarily, including managers and employees working within small to medium enterprises in Lebanon, and all of the questionnaires were fully completed.
Table 1: Corruption existence, forms, and perception at the corporate level

| COR1: Giving gifts to public officials is a way to get things done. |
| COR2: Receiving small gifts and souvenirs from clients is a way to let things be done. |
| COR3: The annual financial statements are reviewed by the external auditors. |
| COR4: The firm is experiencing losses due to vandalism and theft. |
| COR5: The senior management spends enough time for dealing with the requirements of government regulations. |
| COR6: The firm pays for security. |
| COR7: The firm identifies crime, theft, and disorder among its employees and stakeholders as a major constraint to the firm’s activities. |
| COR8: The firm identifies business licensing and permits as a major constraint to the firm’s activities. |
| COR9: The firm identifies the stockholders access to the financial statements as a major constraint to the firm’s activities. |
| COR10: The firm considers the court system as a major constraint to the firm’s activities. |
| COR11: The firm identifies tax rates and tax administration as a major constraint to the firm’s activities. |
| COR12: The firm identifies labor regulations as a major constraint to the firm’s activities. |
| COR13: The top management makes sure that employees and managers follow moral norms and values. |
Table 2: Ethics standards and moral values existence and application at the corporate level.

| ETH1: The company follows a reward system for those who follow the code of conduct or code of ethics. |
| ETH2: Employees who are not abiding by the code of conduct are disciplined. |
| ETH3: In the past five years, the company has not encountered or successfully contained immoral behavior. |
| ETH4: The company appreciates and values employees who follow rules of good conduct and moral principles. |
| ETH5: The company follows a moral strategy in its business planning and decisions. |
| ETH6: The top management understands the need for a moral corporate culture and supports it. |
| ETH7: The company considers all stakeholders in its decisions. |
| ETH8: The company has a standard code of ethics or code of conduct to guide the activities of the board, management, and employees. |
| ETH9: Employees are pushed to be truthful in their reporting and their practices. |
| ETH10: The company integrates fundamental values in its culture such as integrity and dependability. |
| ETH11: The company makes sure that employees feel responsibility towards the organizations and the community as well. |
| ETH12: A whistleblower program protection exists in the company. |
| ETH13: Top management ensures to build and establish credibility with its employees. |
| ETH14: The interest of the organization is prioritized over personal advantages. |
| ETH15: Reporting accurate and reliable financial statements is ensured. |
4.3 Instrumentation

The software program SPSS is adopted to test the previously developed hypotheses and the statistical techniques which are used included the following:

- Descriptive statistics
- Factor analysis for the two main parts of the questionnaire: ethics and corruption
- Structural Equations Modeling (SEM) using SmartPLS 3.
Chapter Five
Statistical Findings

This division shows the statistical results of the questionnaire and covers the following sections: demographics, measurement model, score, factor analysis and the structural model.

5.1 Demographics

Concerning the size of the firm, the majority of the respondents (39%) reported working in a firm composed of 50-200 employees, while 22.9% reported working in a firm of less than 50 employees, 21% in a company with 201-1000 employee, and finally 17.1% in a firm with more than 1000 employee.

Table 3: Size of the firm

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 50 employees</td>
<td>24</td>
<td>22.9</td>
<td>22.9</td>
<td>22.9</td>
</tr>
<tr>
<td>50 – 200 employees</td>
<td>41</td>
<td>39.0</td>
<td>39.0</td>
<td>61.9</td>
</tr>
<tr>
<td>201 – 1000 employees</td>
<td>22</td>
<td>21.0</td>
<td>21.0</td>
<td>82.9</td>
</tr>
<tr>
<td>More than 1000 employee</td>
<td>18</td>
<td>17.1</td>
<td>17.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>105</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Moreover, pertaining to the type or the nature of the business, 8.6% of the respondents reported working in a firm of a manufacturing nature, 9.5% in a firm of a pharmaceutical or medical nature, 1.9% agricultural, 17.1% IT/Telecommunication, 17.1% Commercial, and 8.6% food and beverage. However, a majority of 37.1% reported working in a firm of “other” nature.

Figure 3: Size of the firm
Table 4: Type of the business

<table>
<thead>
<tr>
<th>Valid Type</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>9</td>
<td>8.6</td>
<td>8.6</td>
<td>8.6</td>
</tr>
<tr>
<td>Pharmaceutical – Medical</td>
<td>10</td>
<td>9.5</td>
<td>9.5</td>
<td>18.1</td>
</tr>
<tr>
<td>Agricultural</td>
<td>2</td>
<td>1.9</td>
<td>1.9</td>
<td>20.0</td>
</tr>
<tr>
<td>IT/Telecom</td>
<td>18</td>
<td>17.1</td>
<td>17.1</td>
<td>37.1</td>
</tr>
<tr>
<td>Commercial</td>
<td>18</td>
<td>17.1</td>
<td>17.1</td>
<td>54.3</td>
</tr>
<tr>
<td>Food &amp; Bvrg</td>
<td>9</td>
<td>8.6</td>
<td>8.6</td>
<td>62.9</td>
</tr>
<tr>
<td>Other</td>
<td>39</td>
<td>37.1</td>
<td>37.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>105</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4: Type of the business
As of the change in sales over the past five years, most of the participants (32.4%) stated a slight increase in the average annual sales, 19% stated a significant increase, while 7.6% showed no change, 15.2% witnessed a significant decrease, and finally 25.7% witnessed a slight decrease.

Table 5: Change in sales

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decreased significantly</td>
<td>16</td>
<td>15.2</td>
<td>15.2</td>
<td>15.2</td>
</tr>
<tr>
<td>Decreased slightly</td>
<td>27</td>
<td>25.7</td>
<td>25.7</td>
<td>41.0</td>
</tr>
<tr>
<td>No change</td>
<td>8</td>
<td>7.6</td>
<td>7.6</td>
<td>48.6</td>
</tr>
<tr>
<td>Increased slightly</td>
<td>34</td>
<td>32.4</td>
<td>32.4</td>
<td>81.0</td>
</tr>
<tr>
<td>Increased significantly</td>
<td>20</td>
<td>19.0</td>
<td>19.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>105</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 5: Change in sales
Additionally, regarding the Debt/Equity ratio most of the respondents (52.4%) argued that debt forms 1 to 25 percent of the company’s equity, 31.4% considered that it ranges between 26 and 50 percent, and only 16.2% said that it forms more than 50 percent of the company’s equity.

Table 6: Debt/Equity Ratio

<table>
<thead>
<tr>
<th>Valid</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-25%</td>
<td>55</td>
<td>52.4</td>
<td>52.4</td>
<td>52.4</td>
</tr>
<tr>
<td>26-50%</td>
<td>33</td>
<td>31.4</td>
<td>31.4</td>
<td>83.8</td>
</tr>
<tr>
<td>Above 50%</td>
<td>17</td>
<td>16.2</td>
<td>16.2</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>105</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 6: Debt/Equity Ratio
5.2 The Measurement Model

Reliability analysis was conducted on each of the two major components of the survey: corruption and ethics.

The reliability results are shown below in Table 7. The outcome shows a cronbach’s alpha value of 0.950 for the 13 items of corruption, and 0.969 for the 15 items of ethics. These results indicate a high reliability of the questionnaire so that a further analysis can be proceeded.

<table>
<thead>
<tr>
<th>Construct</th>
<th>Cronbach's Alpha</th>
<th>N of items</th>
</tr>
</thead>
<tbody>
<tr>
<td>COR</td>
<td>0.950</td>
<td>13</td>
</tr>
<tr>
<td>ETH</td>
<td>0.969</td>
<td>15</td>
</tr>
</tbody>
</table>

5.3 Score

The factor analysis provided 1 score for ethical practices denoted by ETH and 2 scores for corruption denoted by CorpConst and CorpPract.

In addition, the two items of performance (change in sales and Debt/Equity Ratio) were combined into a one single performance construct.

5.4 Factor Analysis

Factor analysis is carried on the two major part of the questionnaire: corruption and ethics.
5.4.1 Factor Analysis for Perceived Corruption

The items which are related to corruption resulted in 2 components based on the principal component analysis extraction method. Two items were removed from the analysis (COR4 and COR12) since they loaded highly in both factors.

The rotation matrix based on Varimax with Kaiser Normalization is shown in Table 8 and Table 9.

<table>
<thead>
<tr>
<th></th>
<th>Component 1</th>
<th>Component 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cor1</td>
<td>.717</td>
<td></td>
</tr>
<tr>
<td>Cor2</td>
<td>.686</td>
<td></td>
</tr>
<tr>
<td>Cor3</td>
<td>.725</td>
<td></td>
</tr>
<tr>
<td>Cor5</td>
<td>.826</td>
<td></td>
</tr>
<tr>
<td>Cor6</td>
<td>.862</td>
<td></td>
</tr>
<tr>
<td>Cor7</td>
<td></td>
<td>.851</td>
</tr>
<tr>
<td>Cor8</td>
<td></td>
<td>.822</td>
</tr>
<tr>
<td>Cor9</td>
<td></td>
<td>.719</td>
</tr>
<tr>
<td>Cor10</td>
<td></td>
<td>.785</td>
</tr>
<tr>
<td>Cor11</td>
<td></td>
<td>.774</td>
</tr>
<tr>
<td>Cor13</td>
<td></td>
<td>.811</td>
</tr>
</tbody>
</table>

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.
Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization.

These results show that the two factors accounted for 72.7% of the variance. Moreover, the component matrix shown above reveals that all 13 items of corruption loaded highly, well above the minimum threshold of 0.6.

### 5.4.2 Factor Analysis for COE

The factor analysis for the ethics part of the questionnaire resulted in 1 factor accounting for 70.2% of the variance (Table 11).

Moreover, the component matrix shown below in Table 10 reveals that all 15 items loaded highly, well above the minimum threshold of 0.6.

<table>
<thead>
<tr>
<th>Component</th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.727</td>
<td>.687</td>
</tr>
<tr>
<td>2</td>
<td>-.687</td>
<td>.727</td>
</tr>
</tbody>
</table>
Table 10: Component Matrix for COE

<table>
<thead>
<tr>
<th>Component</th>
<th>Eth1</th>
<th>Eth2</th>
<th>Eth3</th>
<th>Eth4</th>
<th>Eth5</th>
<th>Eth6</th>
<th>Eth7</th>
<th>Eth8</th>
<th>Eth9</th>
<th>Eth10</th>
<th>Eth11</th>
<th>Eth12</th>
<th>Eth13</th>
<th>Eth14</th>
<th>Eth15</th>
</tr>
</thead>
</table>

Extraction Method: Principal Component Analysis.

Table 11: Rotated Component Matrix\(^a\) for COE

<table>
<thead>
<tr>
<th>Component</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.702</td>
</tr>
</tbody>
</table>

\(^a\) Only one component was extracted. The solution cannot be rotated.
5.5 The Structural Model

Figure 7 below shows the results of the structural model.

The implications of the beta values shown in Figure 7 are discussed with reference to Table 12 below.
Table 12: Structural Model coefficient, standard error, t-statistics, and p-values

<table>
<thead>
<tr>
<th>Path</th>
<th>Coefficient</th>
<th>Standard Deviation</th>
<th>T Statistics</th>
<th>P values</th>
</tr>
</thead>
<tbody>
<tr>
<td>COE-Corp</td>
<td>-0.928</td>
<td>0.013</td>
<td>71.306</td>
<td>0.000</td>
</tr>
<tr>
<td>Corp-Perf</td>
<td>-0.806</td>
<td>0.148</td>
<td>5.433</td>
<td>0.000</td>
</tr>
<tr>
<td>COE-Perf (direct)</td>
<td>0.047</td>
<td>0.156</td>
<td>0.303</td>
<td>0.762</td>
</tr>
<tr>
<td>Mediating Effect of Corp on COE-Perf (indirect)</td>
<td>0.749</td>
<td>0.140</td>
<td>5.352</td>
<td>0.000</td>
</tr>
<tr>
<td>COE-Perf (total effect)</td>
<td>0.796</td>
<td>0.036</td>
<td>22.342</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Bootstrap Method was implemented to determine the significance of the path coefficient as well as the indirect and total effect of the COE on corporate performance.

The results reveal that the direct effect of COE on performance is non-significant (path coefficient = 0.047; p value= 0.762). Accordingly, the first hypothesis (H1) that there is a relationship between the COE and corporate performance is rejected.

As for the relationship between COE and perceived corruption, it is highly significant (path coefficient = -0.928; p value= 0.00). This highly significant negative coefficient indicates that there is a strong negative relationship between COE and perceived corruption. These results support the second hypothesis (H2) that there is a negative relationship between COE and corruption. Hence, this entails that companies with a high level of ethical practices through the COE tend to have a lower level of perceived corruption.
With regards to the linkage between perceived corruption and performance, it is highly significant (path coefficient = -0.806; p value= 0.00). This highly significant negative coefficient indicates that there is a strong negative relationship between perceived corruption and performance. These results support the third hypothesis (H3) that there is a negative relationship between corruption and corporate performance.

Consequently, this means that companies with a high level of perceived corruption generally tend to have a lower level of performance.

Concerning the indirect effect of COE on performance, the Bootstrap method results reveal a highly significant path coefficient of 0.749 and a corresponding p-value of 0.00. This result indicates that the COE has a strong positive influence on performance through perceived corruption. Therefore, as the companies’ adoption to the code of ethics increases the level of perceived corruption will decrease and consequently their corporate performance will be enhanced.

Combining the two previous results that:

- COE has no direct effect on performance
- COE has a highly significant effect on performance through perceived corruption

These two results support the fourth hypothesis (H4) that the relationship between the COE and corporate performance is fully mediated by corruption.

The total effect of COE on performance is therefore highly significant with a coefficient of 0.796 and a p-value of 0.00.
Chapter Six

Discussion & Implications

6.1 Discussion

This study was triggered as a result of the idea that Lebanon does not legally enforce any enterprise to espouse a COE or any other ethics-oriented document. It is formulated to prove that the code of ethics is capable of improving the financial outcome of the firm by reducing the level of perceived corruptive practices within its layers. Hence, the research objective involved testing and validating the total mediating effect of perceived corruption on the linkage existing between the COE and corporate performance. Accordingly, the study is initiated with the purpose of inspiring SMEs in Lebanon to adopt the code in order to lessen the perceived corruptive practices within their operations and consequently improve their pecunial activity.

The quantitative analysis resulting from a survey administered in accordance to the “Enterprise Survey” conducted by the World Bank and another survey set by El-Kassar, Messarra & Elgammal (2015) arose five main points of discussion.

First, there is no significant direct effect for the COE on corporate performance. In other words, the existence of ethics in the firm through the implementation of a code of ethics or other document which aims to train or direct the ethical practices of the employees
and the stakeholders can have no primary influence on the financial outcome of the firm. In this sense, companies’ adopting a COE, ethics training programs and other ethics driven standards are not supposed to expect an improvement in their financial statements because of the implementation of the code by itself. This point aligns with the stream of Cummings (2000), Coffey and Fryxell (1991) as well as McGuire, Sundgren, & Schneeweiss (1988) who affirm that there is neither a positive nor a negative connection between the document which aims to regulate the ethics practices of the company’s stakeholders and its profits.

Second, there is a highly significant negative correlation between the COE and perceived corruption. This implies that this negative connection between COE and perceived corruption is noteworthy so that companies which adopt a high level of ethical standards will have a major reduction in the level of perceived corruption because the code mainly addresses issues related to controlling the stakeholders’ rights and responsibilities, developing the employees’ character and so forth. Discursively, the implementation of the COE will basically help the enterprise lessen the degree of unethical and corruptive practices that the employees and other stakeholders might commit. This decrease in the level of perceived corruption will be significant if the code of ethics is associated with a reward system for those who strictly follow it or a penalization system for those who do not abide by it. Within the same context, this conforms to Michael, Carr, & Bowser (2015) who accentuate that ethics and corruption contradict each other. It is also associated with the stream of Garofalo (2001), Eiras (2003), Crocombe (2001), and Dramer (1997) who accentuate that corruption is solely
an ethical and legal problem, assure that the individual’s unethical behavior is the main
cause of corruption and can be avoided through the application of specific laws in this
concern, avow that the lack of ethics attributes are the foundation of corruption and
assure that corruption can be avoided though the effectuation of virtues that target the
character, respectively.

Third, there is a highly significant negative linkage between perceived corruption and
corporate operations. This entails that the perceived corruption-economic performance
contrary linkage is remarkable. Accordingly, companies with a high level of perceived
corruption tend to have a lower level of profits. This might be due to the engagement of
employees and other stakeholders with corruptive acts rather than concentrating on the
successful completion of their tasks. It might also be due to the stakeholders’ different
perceptions regarding corruptive actions so that what is considered ethical and loyal in
one culture could not be accepted in another culture. Further, this negative relationship
could be explained by the corruptive conduct which might reach the accountability of
the core management and consequently threaten the transparency of the firm’s financial
statements as well as its auditing practices. This point upholds the perspectives of
assert that corruption impairs corporate efficiency, aver that pro-accountability programs
enhance the firm’s economic benefits, swan that companies working in an anti-bribes
and anti-corruption environment are more productive than corrupt firms and declare that
the firm’s services are deteriorated by its corrupt circumferent, severally.
Fourth, COE has a significant indirect effect on performance through perceived corruption. Therefore, as the companies’ adoption to the code of ethics increases the level of perceived corruption will decrease and consequently their profits will be enhanced. This is rational since codes of ethics mainly tend to organize the activities of every party which affects or might be affected by the firm. The code addresses legal matters, issues related to the employees behavior toward the company, the customers, and toward each other. It also tends to maintain the core values of the company in addition to identifying the firm’s actions toward the society and classifying the rights and obligations of each stakeholder. All these functions that the code serves will play a fundamental function in constringing the level of perceived corruption taking place in the firm’s operations and accordingly this decrease in the degree of corruption will normally improve the operations of the firm and increase its profits.

Fifth, by taking into account that the COE can have no direct influence on corporate performance and that the COE has a highly significant effect on performance through perceived corruption, it is assured that perceived corruption fully mediates the proportional linkage between the COE and the enhancement in the level of the company’s profits. The code of ethics by itself as a document will have no solid influence on the firm’s financial achievement. However, the adoption of the code will create an environment free of bribes and other corrupt practices. Hence, the efficiency of the employees and other stakeholders will be optimized and as a result the company will optimize its profits. Perceived corruption is the intermediator which helps the code of ethics to enhance the firm’s operations.
6.2 Implications

With relevance to the previously discussed points, companies seeking to enhance their financial performance are recommended to search for possible activities that are capable of eliminating the level of perceived corruption within the firm. One way of decreasing this level is to implement and adopt a code of ethics.
Chapter Seven

Conclusions & Recommendations

This chapter includes a summary of the previous six chapters, a sequent conclusion followed by recommendations, and a suggestion of future research which can be built on this study.

7.1 Summary

This research is investigated to test the total mediating effect of perceived corruption on the relationship between the COE and corporate performance. Chapter I included an overview of the topic, the need to undertake the study, the study objectives and the limitations that restrict the conducted research. Then Chapter II covered prior studies in this concern including the definition of the code of ethics, its content, its propagation, and its functions. This chapter also covered the past researches that were conducted to study the linkage between the COE and corruption, COE and corporate performance, and corruption and corporate performance. Moreover, Chapter III categorized and summarized the main points of view that were discussed in Chapter II reaching then the hypotheses to be tested. Further, Chapter IV defined the methodology adopted in the study to examine the outlined hypotheses. It provided an explanation of the research design, the sample and questionnaire, as well as the instrumentation used. The findings
of the questionnaire are stated in Chapter V where a number of tests is used to validate
the developed hypotheses. This chapter included descriptive statistics in addition to the
result of the factor analysis and the Structural Equations Modeling; these instruments
showed an insignificant direct correlation between the COE and corporate functioning, a
strong negative relationship between COE and perceived corruption and a significant
negative influence for perceived corruption on corporate performance. Chapter VI
encompassed a discussion on the findings reaching an outcome affirming that perceived
corruption plays a total interceding effect on the connection between the COE and the
firms’ performance.

7.2 Conclusions and Recommendations

Although a big number of investigators affirmed through quantitative and qualitative
studies the positive influence that the COE has on the firm’s productivity, this study
succeeded in proving the total mediating role of perceived corruption on the correlation
between the COE and the functioning of the firm. In other words, this study proved that
the code of ethics by itself can have no solid influence on corporate performance, but it
can restrict corruptive actions within the firm and consequently this latter will result in
an enhanced financial performance.

Accordingly, although companies in Lebanon are not legally bound to adopt a code of
ethics, we recommend Lebanese SMEs and the IT firms in particular to adopt a COE or
any similar ethical standards document in order to limit corruptive practices within the
firm and thus to improve their financial outcome.
7.3 Future Research

Other research could be carried on to test the effect of factors other than corruption on the linkage between the COE and corporate performance, such as the organizational structure, the nature of the company, the employees attitude, the cultural context where the firm operates and so forth.

It could also focus on the same factor (corruption) with a broader scope by addressing a sample size larger than 105 participants. This will provide more accurate results concerning the hypotheses aimed to be examined.

Within the same context, the survey could also have concentration on corruption, but to test which one of the corruption scores resulted from the factor analysis could have a stronger mediating effect on the connection between ethics and corruption: corruption practices within the firm or the organization’s perception of the activities that comprise corruption.
REFERENCES


Appendix “A”

We are conducting a study on the “mediating effect of corruption on the relationship between the code of ethics and corporate performance”, and you are kindly asked to complete this short questionnaire as a part of this study which addresses the employees and the managers of SMEs in Lebanon. This questionnaire will be randomly distributed among 100 participants at least and your answers as participants will be totally confidential and your identity will remain anonymous so that when the results of the study are reported, you will not be identified by name or any other information that could be used to infer your identity. Moreover, your participation is voluntary and you may withdraw from this research any time you wish or skip any question. Your refusal to participate will not result in any penalty or loss of benefits to which you are otherwise entitled to.

The research intends to show the mediating role that corruption plays on the relationship between the code of ethics and the performance of SMEs in Lebanon.

If you agree to take part of this research, you are kindly required to place the completed questionnaire in the blank envelope attached to it and seal it.

If you have any questions, you may contact:

Najib Bou Zakhem
E-mail: najib.bouzakhem@lau.edu
Tel: +961 79 109 243

For any further questions about your rights as a participant in this study, or you want to talk to someone outside the research, please contact the:

Institutional Review Board (IRB) Office,
Lebanese American University
3rd Floor, Dorm A, Byblos Campus
Tel: 00 961 1 786456 ext. (2546)

I have read and understood the above, and I agree to participate in the study.

Please check the following box if you would like to participate □
1. What is the size of the firm?
   a) Less than 50 employees
   b) 50 – 200 employees
   c) 201-1000 employees
   d) More than 1000 employee

2. What is the nature of the business?
   a) Manufacturing
   b) Pharmaceutical - Medical
   c) Agricultural
   d) IT- Computational – Telecommunication
   e) Commercial
   f) Food & Beverage-related
   g) Other

3. Over the past five years the average annual sales revenue has:
   a) Decreased significantly
   b) Decreased slightly
   c) No change
   d) Increased slightly
   e) Increased significantly

4. Approximately, what percentage of equity is the company’s debt?
   a) 1-25%
   b) 26-50%
   c) Above 50%
Table 13: The administered survey

Kindly specify your level of agreement with the following statements measuring the level of adherence in the firm where SD represents Strongly Disagree, D represents Disagree, N represents Neutral, A represents Agree, and SA represents Strongly Agree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>SD</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Giving gifts to public officials is a way to get things done.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Receiving small gifts and souvenirs from clients is a way to let things be done.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. The annual financial statements are reviewed by the external auditors.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. The firm is experiencing losses due to vandalism and theft.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. The senior management spends enough time for dealing with the requirements of government regulations.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. The firm pays for security.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. The firm identifies crime, theft, and disorder among its employees and stakeholders as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. The firm identifies business licensing and permits as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. The firm identifies the stockholders access to the financial statements as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. The firm considers the court system as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15. The firm identifies tax rates and tax administration as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16. The firm identifies labor regulations as a major constraint to the firm’s activities.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17. The top management makes sure that employees and managers follow moral norms and values.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18. The company follows a reward system for those who follow the code of conduct or code of ethics.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19. Employees who are not abiding by the code of conduct are disciplined.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20. In the past five years, the company has not encountered or successfully contained immoral behavior.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
21. The company appreciates and values employees who follow rules of good conduct and moral principles.

22. The company follows a moral strategy in its business planning and decisions.

23. The top management understands the need for a moral corporate culture and supports it.

24. The company considers all stakeholders in its decisions.

25. The company has a standard code of ethics or code of conduct to guide the activities of the board, management, and employees.

26. Employees are pushed to be truthful in their reporting and their practices.

27. The company integrates fundamental values in its culture such as integrity and dependability.

28. The company makes sure that employees feel responsibility towards the organizations and the community as well.

29. A whistleblower program protection exists in the company.

30. Top management ensures to build and establish credibility with its employees.

31. The interest of the organization is prioritized over personal advantages.

32. Reporting accurate and reliable financial statements is ensured.

*Your participation is highly appreciated!*