Journal of Business, Economics and Finance (JBEF), ISSN: 2146 – 7943, http://www.pressacademia.org/journals/jbef

PressAcademia

Journal of Business, Economics and Finance

Year: 2017 Volume: 6 Issue: 2

DO BOARD CHARACTERISTICS HAVE AN IMPACT ON CODE OF CONDUCT HANDBOOK IN A COMPANY: AN EVIDENCE FROM TURKEY

DOI: 10.17261/Pressacademia.2017.502
JBEF- V.6-ISS.2-2017(8)-p.134-140

Nazlı Kepce
Istanbul University, School of Business, Department of Accounting, Istanbul, Turkey. nazkepce@istanbul.edu.tr

To cite this document
Kepce, N. (2017). Do board characteristics have an impact on code of conduct handbook in a company: An evidence from Turkey. Journal of Business, Economics and Finance (JBEF), V.6, Iss.2, p.134-140.
Permemant link to this document: http://doi.org/10.17261/Pressacademia.2017.502

ABSTRACT

Purpose- The purpose of this study is to determine whether the board members' characteristics have an impact on the Code of Conduct Handbook for the companies listed in Borsa Istanbul X100.

Methodology- This study is conducted on the information provided by 66 companies listed in Borsa Istanbul X100 and Logistic Regression Model is used for the analysis.

Findings- Total number of board members and number of independent members in the board have a positive impact on the Code of Conduct Handbook in a company.

Conclusion- Only the total number of board members and number of independent members in the board have an impact on the Code of Conduct Handbook in a company. Ratio of female members, ratio of majority of the shares belonging to individuals or corporations', ratio of board members who are also shareholder of the company to total board members have no impact.

Keywords: Ethics, code of ethics, business ethics, code of conduct, board of directors
JEL Codes: M4, M14, G30

1. INTRODUCTION

Epictetus, a Greek Stoic philosopher who lived in early second century AD, stressed a simple yet powerful argument for ethical behavior in his *Discourses.*

".... the rational and the irrational appear such in a different way to different persons just as the good and the bad, the profitable and the unprofitable. For this reason, particularly we need discipline, in order to learn how to adapt the preconception of the rational and the irrational to the several things conformably to nature. But in order to determine the rational and irrational we use not only of external things, but we consider also what is appropriate for each person.... Well, then, it is you who must introduce this consideration into the inquiry, not I; for it is you know yourself, how much you are worth to yourself, and at what price you sell yourself; for men sell themselves at various prices.."

Interest in ethics is nothing new. Throughout human history, ethics has been among the great, concerns of philosophical studies and debates, there have always been notions about what is "right" and what is "wrong". However, only in 20th century did the modern idea of what we now call "business ethics" truly emerged as a result of corporate scandals. The impact of these scandals on the capital markets, globalization, rapid technological developments, changes in the structure and the social role of corporations, changes in socioeconomic and environmental trends, increased the concern against the failure in order to establish and/or to adhere standards of proper conduct and so on. Businesses are started to be confronted with a demand for ethics from all corners of society. This demand is twofold: on the one hand there is a demand for *"integrity"*, on the other for "*social responsibility.* (Jeurissen 2007). Inevitably this increased demand on integrity and corporate social responsibility has led many organizations to establish their own Codes of Conduct having realized that ethical dilemmas can directly impair an organization's reputation and ultimately its financial performance. So what is ethics? What constitutes moral progress? What criteria should we use to evaluate conduct? Can I morally justify my actions? Should I do the so-called right thing if it is against my self-interest? What is the right thing anyhow? Is ethics is a body of knowledge? If so how do we acquire this knowledge? From books? Experience? Both? Employees who are working for an organization need guidance on these matters. That's why in order to give the answers of these questions organizations need to develop their own Codes of Conduct. Corporate Codes of Conduct are practical corporate social responsibility (CSR) instrument commonly used to govern employee behavior and establish a socially responsible organizational culture. The term "Code of Conduct" does not have an authorized definition. Most of the definitions emphasize that a Code of Conduct is a formal statement of the values and business practices of a corporation and particularly helpful when an individual's self-interest is incompatible with acting in accordance with his or her ethical standards.

In its 1999 report Code of Corporate Conduct: Inventory, the OECD Working Party of the Trade Committee defined codes of corporate conduct for the purpose of its survey as?

"Commitments voluntarily made by companies, associations or other entities, which put forth standards and principles for the conduct of business activities in the marketplace".

In its Defining and Developing an Effective Code of Conduct for Organizations: International Good Practice Guidance, the IFAC Professional Accountants in Business Committee defined, "code of conduct" for purposes of the guidance as; (Weiss and Solomon 2011)

"Principles, values, standards, or rules of behavior that guide the decisions, procedures and systems of an organization in a way that (a) contributes to the welfare of its key stakeholders, and (b) respects the rights of all constituents affected by its operations."

Some codes of conduct are labeled as "Code of Ethics"," Code of Business Practices", "Code of Values", "Code of Behaviors" and etc. The most common term seems to be "Code of Conduct", although some companies individualize the title with one of their core values, such as **"**Integrity" or with a phrase such as **"**Performance with Integrity" or "The way we do business". Also it is possible to see separate "Ethics Policy" and "Code of Conduct" of some of the companies. (PAIB, 2007). An organization's ethics policy would be to set out organization's values and principles and organization's Code of Conduct would outline standards of behavior and practices. Each company's ethics program and development of its Code of Conduct are both rooted in company's core values which are important beliefs which shape attitudes and motivate actions. Developing and reviewing a code is the responsibility of Board of Directors and it makes how the company operates visible, how it embeds its core values and how it relates to its stakeholders. On the other hand codes also helps investors and other stakeholders, in particular those looking for socially responsible investment, integrity, and a commitment to ethics.

There is not a standard form of Code of Conduct that should be filled out and issued by companies since core values of one company might be different from another company. There have been several studies performed on how to develop codes of conduct of an organization. It has been found out that the most recent studies take Professional Accountants Business Committee (PAIB) of International Federation Of Accountants (IFAC) Report issued in June 2007 on how a Code of Conduct should be prepared under the name of "Defining and Developing an Effective Code of Conduct: International Good Practice Guidance" as a reference. However as it has already been mentioned that it is just a guide for organizations underlying key principles. The key principles underlying widely accepted good practice guidance according to the IFAC's PAIB Committee uses values as the basis for ethical decision making, indicating that a code cannot cover all ethical and unethical actions. It should only be a guideline for managers and employees to "do the right thing" and sometimes address ethical dilemmas that do not have clear answers. That's why this approach can also be translated into a Code of Conduct by using the term "values-based code".

Development of an organization's ethics policy and Code of Conduct are under the responsibility of Board of Directors. That's why it is highly believed that board characteristics effect the existence, content and implementation of Code of Conduct of a company and there have been several studies performed whether there is a relationship between them or not. The purpose of this paper is to determine whether characteristics of board members have an impact on the Code of Conduct Handbook for the companies listed in Borsa Istanbul X100. Logistic Regression Model and Stepwise Backward Regression Method are used for analysis.

2. LITERATURE REVIEW

Recent corporate scandals and failures have put the spotlight on Board of Directors and numerous suggestions have been made about how to improve the governance of companies in order to rebuild trust. One of the widely discussed issues in academic literature for years is how appropriately and to what extent the structure of the Board of Directors influences board actions or corporate performance. Since developing a Code of Conduct is one of the basic responsibilities of board of directors, we expect that those board characteristics also affect the existence, content and implementation of Code of Conduct Handbook of companies. B*oard size* is one of the well-studied board characteristics because the number of directors may influence the board functioning hence corporate performance. Researchers studied Boards of Directors as decision-making groups by integrating literature on group dynamics and work group effectiveness. From this perspective, board size can both have positive and negative effect on board performance. Goodstein *et al.*1994; Forbes and Milliken, 1999 found out that as the number of members in a board increase, it will have a positive effect since larger boards are likely to have more knowledge and skills, which will provide a larger pool of expertise. Additionally they also found out that large boards may be able to draw on variety of perspectives on corporate strategy and may reduce domination by the CEO. On the other hand Judge and Zeithaml, 1992; Goodstein *et al.*1994; Eisenberg et al. 1998; Forbes and Milliken 1999; Golden and Zajac, 2001 found out that as the board size gets larger, it will have a negative effect because larger boards are more difficult to coordinate and may experience a communication and experience problem. *Board composition* is another well-studied board characteristics having different dimensions such as gender diversity, being a dependent or independent member, being shareholder of the company or not.

Empirical studies on impact of *gender diversity* have produced conflicting results. While Kidwell *et al* 1987; Barnett and Karson 1989; Jaffee and Hyde 2000; Smith and Rogers 2000 found that there is no significant gender differences about perceiving what is ethical or unethical; Stedham *et al* 2007; Bear *et al* 2010 found out that as female members give more importance to what is ethical or unethical and have a positive impact on corporate reputation. *Number of independent members* in a board is another dimension of board composition. Recent changes in corporate governance require firms to maintain boards with a majority of outside independent directors since it is highly believed that outside independent directors will strengthen corporate boards by monitoring actions of management and ensure that management decisions are made in the best interest of the stockholders. However, because of the limited involvement with corporate activities, outside independent directors do not have exposure to the day-to-day activities of the firm and this may actually hinder the efficient operation of Board of Directors (Petra 2005).

Number of board members who are also shareholder of the company is another dimension of board composition. In general, these two dimensions are explained by two conflicting theories, namely Agency Theory and Stewardship Theory. Agency Theory focuses on conflicts of interest that occur among the shareholders and managers stemming from the separation of ownership and control. (Berghe and Levrau 2004) According to Agency Theory managers who gain control may have a potential to pursue actions which will maximize their self-interest at the expense of shareholders. Jensen and Meckling 1976; Fama and Jensen 1983 supports that Board of Directors is one of the mechanism which is designed to monitor conflict of interests that means as the number of independent managers increase in the board, the board may function more effectively and ethically. Stewardship Theory is just the opposite of Agency Theory. According to this theory managers are good stewards of company assets and never misappropriate corporate resources at any price because they have a range of non-financial motives, such as the intrinsic satisfaction of successful performance, the need for achievement and recognition and etc. (Berghe and Levrau 2004). Academic studies provide evidence that support both perspectives.

3. DATA AND METHODOLOGY

It has been already mentioned that Board of Directors are responsible for developing Code of Conduct Handbook of an organization and informing employees and other interest groups. Although companies take into consideration IFAC's PAIB Committee key principles as a guide, board characteristics may affect the development and content of Code of Conduct Handbook. That's why it is believed that there has to be a relationship between the characteristics of the board members and content of the Code of Conduct Handbook of a company. The aim of this paper is to find out whether board characteristics have an impact on the Code of Conduct Handbook for companies. For this purpose information provided from the websites of Borsa Istanbul X100 companies which are operating in Turkey are examined.

As a result of the literature review made the following are mentioned as board characteristics:

- Number of board members
- Ratio of independent members in the board to total number of members
- Ratio of female members in the board to total number of members
- Majority of shares belonging to individuals or corporations
- Ratio of board members who are also shareholder of the company to total board members.

It is highly believed that as the number of board members, independent board members, female board members, ratio of individual board members to total board members, ratio of board members who are also shareholder of the company increase, it is more likely that companies become socially more responsible, their commitment to the ethical rules increase and they will have an increased tendency to prepare a more comprehensive Code of Conduct Handbook and announce it to third parties. To find out whether this is valid for companies operating in Turkey, the following hypothesis is developed:

H_0= Board characteristics do not affect the existence of Code of Conduct Handbook.

H_1= Board characteristics affect the existence of Code of Conduct Handbook

This study is conducted on the companies which are listed in Borsa Istanbul X100 index. Out of 100 companies, information of 92 companies is reached through their websites. It is found out that out of 92 companies, 26 companies do not have a Handbook of Code of Conduct. As a result, this study is conducted on the remaining 66 companies and Logistic Regression Model is used for analysis. Existence of Code of Conduct Handbook is considered as a dependent variable and number of board members (BOARD), ratio of independent members in the board to total number of members (INDMEM), ratio of female members in the board to total number of members (FEMEM), shares belonging to corporations (INSTOWN), shares belonging to individuals (INDOWN), ratio of board members who are also shareholder of the company to total board members (BOARDOWN) considered as independent variables.

4. FINDINGS AND DISCUSSIONS

In order to analyze whether specific board characteristics have an impact on existence of Code of Conduct Handbook, logistic regression model and stepwise backward regression is used at 90% significance level. In the model for the original values "0" denotes companies not having a Code of Conduct Handbook and "1" denotes companies having a Code of Conduct Handbook.

Table 1: Dependent Variable Encoding

Original Value	Internal Value
0	0
1	1

Table 2: Classification Table [a, b]

		Predicted		
		DSCORE		Percentage Correct
	Observed	0	1	
Step 0	DSCORE 0	0	26	.0
	1	0	66	100.0
	Overall Percentage			71.7

a. Constant is included in the model
b. The cut value is .500

Table 3: Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp (B)
Step 0	Constant	.932	.232	16.186	1	.000	2.538

Table 4: Variables not in the Equation

			Score	df	Sig.
Step 0	Variables	FEMEM	.065	1	.800
		INDMEM	2.730	1	.098
		BOARD	2.945	1	.086
		INSTOWN	1.072	1	.300
		INDOWN	1.063	1	.302
		BOARDOWN	.277	1	.598
	Overall Statistics		12.533	6	.051

Table 5: Variables in Equation

		B	S.E.	Wald	df	Sig.	Exp (B)	90% C.I. For EXP.(B)	
								Lower	Upper
Step 1[a]	FEMEM	.006	.021	.085	1	.771	1.006	.972	1.042
	INDMEM	.094	.041	5.361	1	.021	1.098	1.028	1.174
	BOARD	.311	.143	4.750	1	.029	1.365	1.079	1.726
	INSTOWN	38.058	82605.301	.000	1	1.000	33768881312875808.000	.000	.
	INDOWN	38.048	82605.301	.000	1	1.000	33429931469638812.000	.000	.
	BOARDOWN	.017	.018	.881	1	.348	1.017	.987	1.048
	Constant	-3810.020	8260530.129	.000	1	1.000	.000		
Step 2[a]	FEMEM	.005	.021	.066	1	.797	1.005	.972	1.040
	INDMEM	.080	.038	4.478	1	.034	1.084	1.018	1.153
	BOARD	.298	.137	4.747	1	.029	1.347	1.076	1.686
	INSTOWN	.011	.011	1.046	1	.307	1.011	.993	1.030
	BOARDOWN	.019	.018	1.066	1	.302	1.019	.989	1.050
	Constant	-4.808	2.180	4.865	1	.027	.008		
Step 3[a]	INDMEM	.079	.038	4.456	1	.035	1.083	1.018	1.152
	BOARD	.291	.133	4.751	1	.029	1.337	1.074	1.666
	INSTOWN	.011	.011	1.000	1	.317	1.011	.993	1.029
	BOARDOWN	.019	.018	1.066	1	.302	1.019	.989	1.050
	Constant	-4.643	2.070	5.029	1	.025	.010		
Step 4[a]	INDMEM	.080	.037	4.640	1	.031	1.084	1.019	1.152
	BOARD	.298	.133	5.033	1	.025	1.347	1.083	1.675
	BOARDOWN	.014	.017	.665	1	.415	1.014	.986	1.043
	Constant	-4.056	1.962	4.272	1	.039	.017		
Step 5[a]	INDMEM	.077	.036	4.479	1	.034	1.080	1.017	1.147
	BOARD	.282	.129	4.793	1	.029	1.326	1.073	1.639
	Constant	-3.725	1.874	3.951	1	.047	.024		

a. Variable(s) entered on step 1: FEMEM, INDMEM, BOARD, INSTOWN, INDOWN, BOARDOWN

Based on the hypothesis developed and given below it is expected that all of the board characteristics determined have a significant impact on the development of code of conduct handbook.

H_0 = Board characteristics do not affect the existence of Code of Conduct Handbook.

H_1= Board characteristics affect the existence of Code of Conduct Handbook

However it is found out that only the number of independent members (INDMEM) and total number of board members (BOARD) have a significant impact on the development and existence of Code of Conduct Handbook in companies. Details of the analysis conducted are as follows:

- Having independent members (INDMEM) in the board has a significant impact (.034 < .50) on the development of Code of Conduct Handbook in a company and when we look at its "B" value which is .077, we see that this is a positive impact since the sign of the value is positive. To be more specific we also have to also look at "Exp. (B)" value, we see that as the number of independent members increase by 1, the possibility of having a Code of Conduct Handbook increases 1.080 times and at 90% significance level this value may change within the interval of 1.017-1.147.
- Total number of members in the board (BOARD) has a significant impact (.029 < .50) on the development of Code of Conduct Handbook in a company and when we look at its "B" value, which is .282, we see that this is a positive impact since the sign of the value is positive. To be more specific we have to also look at "Exp. (B)" value, we see

that as the number of independent members increase by 1, the possibility of having a Code of Conduct Handbook increases 1.326 times and at 90% significance level this value may change within the interval of 1.073-1.639.

This result can be summarized in the following logistic regression equation. -3.725 is directly taken from Table 5 as the constant of the equation.

y= -3,725+0,077INDMEM+0,282BOARD

5. CONCLUSION

Taking into consideration the problems of trust experienced after recent financial scandals, Codes of Conduct Handbook is an increasingly popular tool for promoting, encouraging and guiding responsible behavior. Board of Directors are responsible for standing of their company in the community and developing a Code of Conduct for a company is just one of the basic responsibilities of it. That's why it is highly believed that board characteristics affect the existence, content and implementation of Code of Conduct Handbook of a company. As a result of the study conducted to determine whether board characteristics have an impact on development of Code of Conduct Handbook for the companies listed in Borsa Istanbul X100, it is found out that only the increase in the number of total board members (BOARD) and in the number of independent members (INDMEM) have a significant positive impact on the development and the existence of Code of Conduct Handbook at 90% significance level, whereas the other independent variables have no impact at all.

REFERENCES

Barnett, J.H. and Karson, M. 1989, "Managers, Values and Executive Decisions: An Exploration of the Role of Gender, Career Stage, Organizational Level Function and Managerial Decision Making", *Journal of Business Ethics,* vol.8, issue 10, pp. 747-771.

Bear, S., Rahman, N. and Post N. 2010, "The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation", *Journal of Business Ethics,* vol.97, issue 2, pp.207-221 .

Eisenberg, T., Sundgren, S. and Wells, M.T. 1998, "Larger Board Size and Decreasing Firm Value in Small Firms", *Journal of Financial Economics*, vol.48, pp.35-54.

Fama, E.F. and Jensen, M.C. 1983, "Separation of Ownership and Control", *Journal of Law and Economics,* vol.26, pp.327-349.

Forbes, D.P. and Milliken, F. 1999, "Cognition and Corporate Governance: Understanding Board of Directors as Strategic Decision-Making Groups", *Academy of Management Review*, vol. 3, pp.489-505.

Golden B.R. and Zajac, E.J. 2001, "When will Boards Influence Strategy? Inclination X Power=Strategic Change", *Strategic Management Journal,* vol.22, issue 12, pp.1087-1111.

Goodstein, J., Gautam, K. and Boeker, W. 1994, "The Effects of Board Size and Diversity on Strategic Change"*, Strategic Management Journal*, vol.15, issue 3, pp.241-250.

Guest, P.M.2009, "The Impact of Board Size on Firm Performance: Evidence from the UK", *The European Journal of Finance*, vol.15, issue 4.

Ibrahim, N., Angelidis, J. and Tomic I.M., 2009, "Managers' Attitudes toward Codes of Ethics: Are There Gender Differences?" *Journal of Business Ethics,* vol.90 supplement 3, pp.343-353.

IFAC Professional Accountants in Business Committee, June 2007, "Proposed Good Practice Guidance on Defining and Developing an Effective Code of Conduct".

Jaffe, S. and Hyde J.S. (2000), "Gender Differences in Moral Orientation: A Meta-Analysis", *Psychological Bulletin,* vol.126, issue 5, pp.703-726.

Jensen, M.C. and Meckling, W.H. 1976, "Theory of The Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics,* vol.3, pp.306-360.

Jeurissen, R. (Editor) 2007, "Ethics & Business", 2007 Van Gorcum.

Judge, W.Q. Zeithaml, C.P. 1992,"Insittutional and Strategic Choice Perspectives on Board Involvement in the Strategic Decision Process", *Academy of Management Journal,* vol.35, no.4, pp.766-794.

Kidwell, J., Stevens R., and Bethke, R., 1987, "Differences in Ethical Perceptions Between Male and Female Managers: Myth or Reality?", *Journal of Business Ethics,* vol.6, issue 6, pp.489-493.

OECD Working Party of Trade Committee 1999, "Code of Corporate Conduct: Inventory".

Petra S.T. 2005, "Do Outside Independent Directors Strengthen Corporate Boards?", *Corporate Governance: The International Journal of Business in Society*, vol.5, issue 1, pp.55-64.

Smith, A. and Rogers V., 2000, "Ethics-Related Responses to Specific Situation Vignettes: Evidence of Gender-Based Differences and Occupational Socialization", *Journal of Business Ethics,* vol.28, issue 1, pp.73-85.

Stedham Y., Yamamura J.H. and Beekun R.I. 2007, "Gender Differences in Business Ethics: Justice and Relativist Perspectives", *Business Ethics: A European Review,* vol. 16, no. 2, pp.163-174.

Weissi M.M. and Solomon M.E. 2011, "Auditing IT Infrastructures for Compliance", John's and Bartless Learning Books.

Van den Berghe L.A.A. and Levrau A. 2004, "Evaluating Boards of Directors: What constitutes a Good Corporate Board", *Corporate Governance,* vol.12, no. 4, p.462.

Yermack, D.1996, "Higher Market Valuation of Companies with a Small Board of Directors", *Journal of Financial Economics,* vol.40, issue 8, pp.185-211.

http://classics.mit.edu/Epictetus/discourses.1.one.html, April 29, 2017.