APPLICATION OF LAOZI'S DAODEJING TO CURRENT CORPORATE GOVERNANCE

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ABSTRACT

This study explores the relationships among the leader’s ethical spirit, leader’s social responsibility, internal corporate governance mechanisms (ICGMs), and shareholder rights in the Taiwanese export industry from the viewpoint of stakeholders. It takes into account of Laozi’s Daodejing (DDJ) for Daoism philosophy in order to create the criteria on ethical spirit and social responsibility for Taiwanese leader. After reviewing OECD principles for corporate governance and Taiwanese company laws on ICGMs and shareholder rights, a conceptual framework is established based on hypotheses relating to possible influential factors. An empirical study was conducted among 265 stakeholders in the Taiwanese export industry. The results show that the leader’s ethical spirit has positive effects on his social responsibility and on ICGMs, but has an indirect effect on shareholder rights. The leader’s social responsibility has a positive influence on ICGMs. Moreover, social responsibility and ICGMs play a significant role in shareholder rights.

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Keywords: Leader’s ethical spirit, Leader’s social responsibility, Internal corporate governance mechanisms, Shareholder rights.

1. INTRODUCTION

The Asian financial crises have provided lessons on the importance of corporate governance. Inadequate corporate governance was identified as a key factor in the failure of Asian corporations to build competition in world financial markets. The Taiwanese securities regulator (Financial Supervisory Commission, FSC) has emphasized the importance of corporate governance to public companies since 1998. In the early 2000s, corporate scandals seriously affected Taiwanese economic development and political stability.

However, a typical solution is to change the institution in which individuals operate, making little attempt to reform the psyche of the individual. One assumption is that these problems can be
attributed to the ethics and moral character of individuals. Those holding leadership roles in governance are influenced by a set of processes, customs, policies, laws, and institutions affecting the way a corporation is directed, administered or controlled. However, individuals are accepted for what they are – which is to say, mostly selfish – and the emphasis is on changing the rules of the game to ensure that people’s interests are properly aligned to produce the outcomes that justice and morality require (Bragues, 2008). The empirical evidence, however, suggests that the institutional approach will do little to prevent future ethical breakdowns.

Berle and Means (1932) initially pointed out that if the managers blindly pursue self-benefits, the company policies they make may depart from the goal of maximizing shareholder equity. This was the first definition of the principal agent problem.

Agency problems of moral hazard continue to challenge principals owing to two fundamental conditions that underlie principal-agent relationships between shareholders and the executive on goal incongruence and information asymmetry (Jensen and Meckling, 1976; Fama, 1980; Levinthal, 1988; Zajac, 1990). Scholars have proposed internal corporate governance mechanisms (ICGMs) to reduce agency costs (Williamson, 1983). Principals can address these issues using a variety of ICGMs for monitoring agents (Hart, 1995) and the mechanisms used are likely to vary according to the shareholder rights of a firm. Our primary focus here is on ICGMs for controlling agency issues such as the ethical behavior of leaders under OECD corporate governance through the board of directors. We also consider how responsibility affects the manner in which ICGMs relate to shareholder rights.

ICGMs are established by the board of directors, who represent shareholders, to reduce and control agency problems, and partly to reduce monitoring costs. ICGMs have received much attention as a means for protecting shareholders: they provide structures and processes by which to direct and manage the company and they deliver management accountability and thus protect shareholder rights.

Theoretically, the board of the directors may solve principal-agent problems (Tu et al., 2007). ICGMs include the relationships among the stakeholders involved and the corporation goals. The aim of corporate governance is to ensure leader accountability through ICGMs that reduce or eliminate the principal-agent problem. An OECD preamble suggests that governments have an important responsibility for shaping an effective regulatory framework. This should provide sufficient flexibility to allow markets to function effectively and to respond to the expectations of shareholders and other stakeholder on corporate governance.

In addition to commercial objectives, companies are encouraged to disclose policies relating to business ethics, the environment and other public policy commitments (Organisation for Economic Co-operation and Development, 2004). Corporate governance also involves issues such as the viewpoint of stakeholder and models for a good overview of different theoretical perspectives on corporate governance (Dignam and Lowry, 2006). The aim of this study is to determine the main factors that influence the ethics and moral behavior of a leader in terms of the ancient Chinese philosophy of Daoism.

Here we investigate whether the ethics and moral behavior of Chinese leaders reflect the viewpoints of Laozi, an ancient Daoism philosopher. We argue that it is important for such firms to follow Laozi’s Daodejing (DDJ; ethical spirit and social responsibility) in combination with
modern corporate governance tools (e.g. ICGMs and shareholder rights) to establish suitable corporate governance criteria.

2. LITERATURE REVIEW

2.1. DDJ criteria among ethical spirit, social responsibility, ICGMs and shareholder rights

We first established parameters for four constructs. To do this, we reviewed various boards, strategic management roles, executives, directors, and business leaders to obtain an overall definition of an ethical leader. For the purposes of this review, ethical spirit refers to the behavioral ethics of a leader subject to or judged according to generally accepted moral norms of behavior, taking into account the DDJ. Laozi was an ancient political philosopher (557–479 BC) who was the founding father of Daoism. He advocated benevolent, never aristocratic, rule, a system basically similar to the traditional Chinese Confucianism (Yang, 2000). We applied this ancient view to the modern commercial realities of corporate governance to connect virtuous behavior to enlightened self-interest and thus offer a compelling ethics code for business leaders.

Hence, 20 DDJ items translated into criteria by Meng and Liang (2011) were used as survey items in our research model on ethical leadership and responsibility. This study confirms that the DDJ is an appropriate tool for evaluating ethical leadership. These 20 items were used to build four constructs in relation to ICGMs and shareholder rights. We therefore relate ethical spirit to social responsibility and shareholder rights and propose six hypotheses for testing. Thus, research on ethical spirit is primarily concerned with explaining leader behavior in the context of the ancient social prescriptions of Daoism.

Others have focused on ethical behavior defined as acts that reach some moral standard and are therefore not unethical, such as honesty or obeying the law. Still others have focused on ethical behavior defined as behaviors that exceed moral minimums (Trevino et al., 2006) in western ethics researches. Second, our definition of social responsibility encompasses a leader’s power in relation to ethical behavior, and thus our review considers a broader range of topics than recent reviews on, for example, ethical decision-making (O’Fallon and Butterfield, 2005) and ethical conduct (Trevino and Weaver, 2003).

Third, given the size of the literature on OECD guidelines on corporate governance and company laws, we restrict our review to social scientific contributions to this field. Fourth, for our empirical study we consider a theoretical foundation in terms of OECD guidelines on shareholder rights, key ownership functions, company law and equitable treatment of shareholders, as well as regulations of the Taiwan Stock Exchange and the FSC.

2.2. Hypothesis Development

2.2.1. Relationship between ethical spirit and social responsibility

Jones (1995) stated that an ethical leader will increase ethics awareness and accountability within her organization. Husted and Allen (2000) proved that personal ethics values and social responsibility are linked to corporate objectives as an element of management discourse. Windsor (2001) assessed two fundamentals of social responsibility are the prevailing psychology of the manager, and the normative framework for addressing how this psychology should be shaped in the
future for corporate social responsibility. Frankental (2001) described corporate social responsibility as a view of an organization’s ethical stance. Joyner and Payne (2002) suggested that firms should instill business ethics in their employees to encourage them to engage in socially responsible behavior with respect to their environment and community, and that this can boost profits. Trevino et al. (2003) argued that ethical leader is an outside the executive suite to engage in socially salient behaviors that make the executive stand out as an ethical figure since they are also concerned about the interests of multiple stakeholders, including the community and society.

Garriga and Mele (2004) argued that the principles rightly express how to achieve a good society via ethical requirements that cement the relationship between business and society. Waldman et al. (2006) found that CEO intellectual stimulation was significantly associated with the propensity of a firm to engage in strategic corporate social responsibility. Ethical leaders participate in seminars on the virtues and benefits of corporate donation and learn of such behavior from their counterparts in other cities and when they are exposed to pressure to behave in these socially responsible ways (Campbell, 2007).

De Hoogh and Den Hartog (2008) showed that leaders with strong social responsibility were rated higher on ethical leadership and lower on despotic leadership. Messick (2009) proved that insights from contemporary psychology can illuminate the common psychological processes that facilitate unethical decision-making. Fulmer and Barry (2009) proved that a leader’s positive mood or emotion can also reduce the likelihood of engaging in detailed critical thinking and is also less likely to cause concern about dubious unethical activities. Meng and Liang (2011) proved that a leader’s ethical spirit is positively related to his social responsibility. Meng (2013) described Menczi of the ancient philosopher Mencius and relates them to a leader’s moral spirit and a leader’s implementation of humane governance with today’s ethical criteria as used in Taiwan. Hence, the following hypothesis is proposed:

**Hypothesis 1** The ethical spirit of a leader has a positive effect on his social responsibility.

### 2.2.2. Relationship between ethical spirit and ICGMs

An ideal control system should regulate both motivation and ability via the insistence of a leader. Agency problems of moral hazard and adverse selection in the context of corporate governance develop under information asymmetries between agents and principals. These problems occur when managers in possession of information make decisions that are self-serving, engage in executive perquisites and moral hazard, or misrepresent skills and abilities (adverse selection) in the hiring process (Eisenhardt, 1989; Rutherford and Buchholtz, 2007; Rutherford et al., 2007; Ward et al., 2009).

There is evidence that a weak internal corporate control structure, including a firm’s leadership, procedures and structures headed by the board of directors, the CEO and the controlling shareholders, encourages and facilitates the occurrence of occupational crimes (Beasley, 1996; Beasley et al., 2000; Trevino et al., 2003; Zahra et al., 2005). Trevino et al. (2003) found that the ethical dimension of executive leadership can influence employees and organizational behavior. For example, in the Enron case, the executives created a culture that set the stage for the conflicts of interest and unethical accounting practices that led to the firm’s downfall.
Arjoon (2005) argued that legal compliance mechanisms are insufficient in dealing with fraudulent practices and may not be addressing the real and fundamental issues. Thus, a tendency to overemphasize legal compliance mechanisms may result in an attempt to substitute accountability for responsibility and to legislate for morality, which consequently leads to legal absolutism. Tu et al. (2007) proved that internal mechanisms for establishing a board of directors to represent shareholders, to reduce and control agency costs and to participate in the operation can reduce monitoring costs.

To repair moral legitimacy, organizations often address procedures and structures, as well as the individual perspective (Wang, 2010). By contrast, disassociation from illegitimate organizational structures and the creation of monitors are more effective strategies for firms punished for embezzlement or stock market manipulation, both of which have a negative effect on the moral legitimacy of Chinese listed firms (Wang, 2010). ICGMs are designed to reduce the inefficiencies that arise from moral hazard and adverse selection in order to monitor their leader’s ethical behavior. Based on the above arguments in the literature, the second hypothesis is as follows:

**Hypothesis 2** The ethical spirit of a leader has a positive effect on ICGMs.

### 2.2.3. Relationship between ethical spirit and shareholder rights

Investors evaluate moral legitimacy by examining an individual’s behavior (Scott, 1977). Cohen et al. (1987) highlighted this fact in the context of investment management with a discussion of risk, measures of risk, and the ways in which investor considerations are the result of corporate officers’ failure to feel a sense of ethical responsibility toward their investors. Weber (1968) stated that consideration of this type of rise is inevitable in investment decisions. He implied that the depersonalization of financial markets renders a CEO incapable of feeling a direct obligation to his company’s share owners and the holders of its debt instruments.

Market investors use examination procedures and structures to evaluate moral legitimacy (Scott and Meyer, 1991). Jones (1995) found that an ethical leader increases the probability of an organization’s economic success because uncertainty is reduced for investors. The board of director is another mechanism through which shareholder can influence the behavior of managers to ensure that a company is run in their interests (Hemailin and Weisbach, 2003). According to Nicholson and Kiel (2004) the supervision abilities of a board to adequately monitor a large and complex organization depend on its directors’ knowledge, morals, skills and experience. Ong and Wan (2008) referred to director abilities in terms of legitimacy, experience and ethics abilities to link the firm to key stakeholders or other important parties.

The board of directors, as a collective representative of shareholder interests in the Anglo-Saxon governance model, bears the ultimate responsibility for avoiding moral hazards and adverse selection (Ward et al., 2009). In a Chinese scenario, Wang (2010) argued that moral legitimacy is at issue when embezzlement or stock market manipulation is detected in a firm; market investors will believe that the firm intends to act in a manner contrary to their interests and that their interests cannot be properly protected by the existing internal control structure. The following hypothesis is derived from the above arguments:

**Hypothesis 3** The ethical spirit of a leader has a positive effect on shareholder rights.
2.2.4. Relationship between social responsibility and ICGMs

The notion of social responsibility was initially advocated by Drucker (1974), who stated that corporations should participate in social activities and feel a sense of self-ombudsmanship. Many previous studies have found that corporations act in socially responsible ways to influence institutional mechanisms (Bühner et al., 1998; Orlitzky et al., 2003; Walsh et al., 2003; Doh and Guay, 2006). Furthermore, institutional determinants affect corporate social responsibility because firms are embedded in a broad set of political and economic institutions that affect the behavior of leaders (Fligstein, 1990; Campbell et al., 1991; Roe, 1991; Roe, 1994; Fligstein, 2001; Campbell, 2007). The primary responsibility of a leader is to protect and enhance firm value through a variety of functions, including advising management and providing access to external resources; additional utility from controlling agency costs also contributes to the firm’s value (Jensen and Meckling, 1976).

Many researchers, including Maignan and Farrell (2000), Bromley (2002) and Kashyap et al. (2006) supported the concept of social responsibility by corporations and proposed that information on corporate compliance with legal rules and regulations and economic contributions should be reported to consumers, the community, competitors and the government. Dawkins (2004) stated that social contributions attract motivated potential employees and improves the commitment level of existing executives. Brammer et al. (2007) noted that social responsibility increased employee organizational commitment. Therefore, we investigated the effects of social responsibility on leader organizational commitment in the context of Taiwan.

According to the Organisation for Economic Co-operation and Development (2004), board responsibility should include review of and guidance on corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestitures. The board is chiefly responsible for preventing conflicts of interest and balancing competing demands to oversee systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labor, environmental, equal opportunity, and health and safety laws.

In some OECD countries, companies have found it useful to explicitly articulate the responsibilities that the board assumes and those for which management is accountable. Heslin and Achoa (2008) also emphasized the strategic significance of corporate social responsibility for corporate success. They distinguished social responsibility from related and confounded corporate resource allocations and from corporate social performance. They then incorporated the capacity for stakeholder influence into a conceptual framework that illustrates how acts of social responsibility are transformed into corporate financial performance through stakeholder relationships.

Chiang and He (2010) stated that board members are responsible for supervising company operations and that firm value is influenced not only by managers’ actions, but also by those of board members, which should enhance the governance effect and improve a company’s transparency and the quality of its information. Studies have suggested that corporate social responsibility increases corporate governance levels in an organization, because social
responsibility interventions include activities that affect the internal mechanisms for executives and their boards. Therefore, the following hypothesis is proposed:

**Hypothesis 4** The social responsibility of a leader has a positive effect on ICGMs.

### 2.2.5. Relationship between social responsibility and shareholder rights

According to Butcher (1987) and Kelly (1990), ethical leaders are valuable and prosperity-seeking organizations would be well advised to obtain the social services of such leaders, who exhibit self-evident moral principles. Many previous studies have identified a positive relationship between corporate social responsibility and firm profitability (Cowton, 1994; Mallin et al., 1995; Sauer, 1997; Cummings, 2000). Most studies of the determinants of corporate social responsibility examined the effects on various aspects of corporate financial performance, but not much else (Fry et al., 1982; McGuire et al., 1988; Brown and Perry, 1994). It is consistently evident that ethical behavior is the result of a socialization process infinitely more thorough than any company program (Jones, 1995).

Theoretically oriented research on this subject has focused on the positive connection between corporate social responsibility and financial performance (Rowley and Berman, 2000; Walsh et al., 2003). Lee and Park (2010) investigated linear relationships between corporate social responsibility and the performance of airline companies in terms of accounting and value performance. According to Campbell (2007), firms with a financial performance so weak that they risk suffering serious losses and jeopardizing shareholder value may be less inclined to meet even the minimum threshold of socially responsible compared to firms whose financial situation is stronger and act in socially responsible ways to maximize profit and shareholder value. Windsor (2006) argued that ethical responsibility advocates strong corporate self-restraint and altruistic activities and an expansive public policy that strengthens stakeholder rights, and that corporations should earn positive financial returns from social responsibility.

According to the Organisation for Economic Co-operation and Development (2004), board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. Moreover, shareholders are not expected to assume responsibility for managing corporate activities. The board is responsible for corporate strategy and operations are typically placed in the hands of a management team that is selected, motivated and, when necessary, replaced by the board. Shareholders must be aware of market participants with risks related to environmental liabilities. Ali et al. (2010a) stated that corporations use social responsibility to strengthen their relationship with shareholders to ensure minimum conflicts and maximum loyalty from all shareholders.

This supports the notion that the social responsibility of a leader has a positive influence on value performance, but not on accounting performance. Lo and Sheu (2010) noted that firms integrate economic, environmental and social dimensions to create long-term value for stakeholders and stockholders. Although there is a substantial body of literature on corporate social responsibility in relation to financial profitability, very few studies have addressed the issue of social responsibility in terms of integrating shareholder rights in value creation for ethical leaders. The focus has been on determining the extent to which socially responsible corporate behavior affects financial performance. In other words, non-financial criteria for performance such as
management quality, corporate governance structures, reputation risks, human capital management, stakeholder relations, environmental protection, and corporate social responsibility have not been captured in the context of ethical leaders. Ali et al. (2010b) noted that corporate social responsibility itself has positive effects on organizational performance by building a positive reputation among investors, which results in favorable decisions with respect to the corporation. Leaders with a good social responsibility reputation provide many competitive advantages, which again positively affect the performance of a firm.

The nexus between social commitment, social responsibility and organizational performance has been investigated by many researchers. The current study investigates these relationships in a theoretical model. Therefore, the following hypothesis is proposed:

Hypothesis 5 The social responsibility of a leader has a positive effect on shareholder rights.

2.2.6. Relationship between ICGMs and shareholder rights

Healy and Palepu (2001) argued that there must be an unbiased communication protocol to retain a solid relationship between a company and its investors and prevent information asymmetry in the market. The Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) defines corporate governance as a set of mechanisms that maintains an appropriate balance between the rights of shareholders and the needs of the board and management to direct and manage a corporation’s affairs. According to the Organisation for Economic Co-operation and Development (2004), effective use of ownership rights to monitor and influence the board requires basic standards of disclosure and transparency. Moreover, experience has shown that an important determinant of the degree to which shareholder rights are protected is whether effective methods exist to obtain redress for grievances at a reasonable cost and without excessive delay. Furthermore, processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Information about board and executive remuneration is also of concern to shareholders, in particular the link between remuneration and company performance.

Farber (2005) showed that if a fraudulent firm makes improvements in its ICGMs, investors perceive the firm to be more legitimate because they believe the firm can provide more value and be more credible. Companies should be supervised under sound mechanisms and transparency requirements can demonstrably protect shareholder rights. It is important for the market to know whether a company is being run with due regard to transactions with related parties transactions in the interests of all its shareholders.

It is essential for a company to fully disclose material related to party transactions to the market, either individually or on a grouped basis, including whether they have been executed at arm-length and on normal market terms (Organisation for Economic Co-operation and Development, 2004). Cremers and Nair (2005) proved that internal mechanisms represent a strong complement, producing annualized abnormal returns of 10–15%, depending on the proxy for internal governance.

In addition, a useful tool for determining the effectiveness of and interactions among various governance mechanisms is provided by the equity price. In some OECD countries, shareholders have direct responsibility for nominating and electing non-executive directors to specialized functions; furthermore, board members enjoy legitimacy and confidence in the eyes of shareholders.
Chiang and He (2010) used both primary and archival data in an empirical study of Taiwanese companies. They found that internal mechanisms can encourage a board of directors to act in the best interests of shareholders. Finally, the following hypothesis is proposed:

**Hypothesis 6** ICGMs have a positive effect on shareholder rights.

### 3. RESEARCH DESIGN AND METHOD

#### 3.1. Questionnaire Design

Data for this study were collected using a survey questionnaire. First, 20 items of ethical spirit and social responsibility were referenced from Meng and Liang (2011) and Meng (2013). Second, the ICGMs item was according to company law in Taiwan and Organisation for Economic Co-operation and Development (2004) principles of corporate governance to construct measurement items for shareholder rights. A seven-point Likert scale is most commonly used for questionnaires (Driscoll et al., 1994; Gallarza et al., 2002). Thus, attitudes to each of the items were assessed using a seven-point Likert scale, with 1 corresponding to ‘strongly disagree’ and 7 to ‘strongly agree’.

Based on the literature review, expert recommendations and item analysis, the 40 items listed in Table 1 were included in the questionnaire. These 40 items were pre-tested on thirty stakeholders who came from export and shipping members. The analysis results confirmed that the validity of all 40 items was very good. The survey was distributed to 550 member firms and carried out during May to July 2012 and 317 questionnaires were returned. 52 of the 317 questionnaires returned were discarded because of incomplete information. There were 265 usable responses in total, for an overall response rate of 48.1%.

#### 3.2. Analysis approach

Statistical analyses and factor analysis were conducted using SPSS. Factor analysis was performed to investigate any separate underlying factors and to reduce redundancy. To test the relationship, we used structure equation modeling (SEM) on four structures among ethical spirit, social responsibility, ICGMs and shareholder rights using AMOS.

### 4. RESULTS

#### 4.1. Measurement model

The adequacy of the measurement model was assessed by confirmatory factor analysis (CFA). The conceptual model for the test included four constructs comprising ethical spirit, social responsibility, ICGMs, and shareholder rights. All of the CFA fit indices indicated a good fit, with \( \chi^2=3116.380, \text{ df}=734 \), comparative fit index of 0.803, goodness-of-fit index of 0.613, Tucker-Lewis index of 0.791, and root mean square error of approximation of 0.110. The CFA results satisfy the recommended level of goodness of fit, which indicates that the measurement model fits the sample data well.

#### 4.2. Discriminant validity

The discriminant validity of a construct is established when its square root of AVE is greater than the correlation coefficients between that construct and all other constructs (Fornell and Larker, 1981).
In addition, discriminant validity can be assessed for each pair of estimated constructs by constraining the estimated correlation parameter between them to 1 and a $\chi^2$ difference test performed on the values obtained from the constrained and unconstrained models (Joreskog, 1971; Anderson and Gerbing, 1988). The results shown in Table 1 indicate that the measurement model met the discriminant validity criterion.

<table>
<thead>
<tr>
<th>Construct and items</th>
<th>SL</th>
<th>t-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethical spirit ($\alpha$=0.892; CR=0.910; AVE=0.83)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leader behaves with civility and humility</td>
<td>0.756</td>
<td>15.990</td>
</tr>
<tr>
<td>Leader is caring and virtuous</td>
<td>0.764</td>
<td>16.266</td>
</tr>
<tr>
<td>Leader is committed to advocacy of moral concepts</td>
<td>0.764</td>
<td>16.265</td>
</tr>
<tr>
<td>Leader has industrious and frugal habits</td>
<td>0.566</td>
<td>10.421</td>
</tr>
<tr>
<td>Leader has an ethical mind from the perspective of people</td>
<td>0.891</td>
<td>22.196</td>
</tr>
<tr>
<td>Leader is selfless in relation to the company and society</td>
<td>0.819</td>
<td>18.487</td>
</tr>
<tr>
<td>Leader has great moral faith</td>
<td>0.853</td>
<td>20.104</td>
</tr>
<tr>
<td>Leader exhibits goodness and integrity</td>
<td>0.893</td>
<td>24.112</td>
</tr>
<tr>
<td>Leader sacrifices his own interests to share with others</td>
<td>0.799</td>
<td>17.648</td>
</tr>
<tr>
<td>Leader shows patience and peace of mind</td>
<td>0.816</td>
<td>18.372</td>
</tr>
<tr>
<td>Social responsibility ($\alpha$=0.807; CR=0.823; AVE=0.81)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leader does not enforce malicious layoffs or pay cuts</td>
<td>0.842</td>
<td>25.019</td>
</tr>
<tr>
<td>Leader treats each stakeholder equally</td>
<td>0.850</td>
<td>18.047</td>
</tr>
<tr>
<td>Leader places emphasis on staff health and a safe working environment</td>
<td>0.860</td>
<td>18.420</td>
</tr>
<tr>
<td>Leader cares for the environment and prevents pollution</td>
<td>0.849</td>
<td>18.017</td>
</tr>
<tr>
<td>Leader establishes a task force for social responsibility in the company</td>
<td>0.813</td>
<td>16.767</td>
</tr>
<tr>
<td>Leader treats multinational employees with respect for their cultures and civil rights.</td>
<td>0.861</td>
<td>18.457</td>
</tr>
<tr>
<td>Leader takes care of socially vulnerable groups.</td>
<td>0.833</td>
<td>17.450</td>
</tr>
<tr>
<td>Leader cares for labor rights.</td>
<td>0.866</td>
<td>18.662</td>
</tr>
<tr>
<td>Leader shows equal concern for employee welfare and shareholder equity</td>
<td>0.888</td>
<td>19.501</td>
</tr>
<tr>
<td>Leader is dedicated to social responsibility</td>
<td>0.870</td>
<td>18.806</td>
</tr>
<tr>
<td>ICGMs ($\alpha$=0.907; CR=0.921; AVE=0.89)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leader is in strict compliance with laws and regulations</td>
<td>0.765</td>
<td>15.962</td>
</tr>
<tr>
<td>Leader introduces internal control procedures for office policy</td>
<td>0.864</td>
<td>19.958</td>
</tr>
<tr>
<td>Leader appoints an audit committee or supervisors</td>
<td>0.862</td>
<td>19.884</td>
</tr>
<tr>
<td>Leader willing to accept independent directors of functions</td>
<td>0.781</td>
<td>16.544</td>
</tr>
<tr>
<td>Leader assigns normal capital allocation and obeys financial norms</td>
<td>0.312</td>
<td>5.212</td>
</tr>
<tr>
<td>Leader supervises the implementation of significant assets and derivatives trading</td>
<td>0.867</td>
<td>20.136</td>
</tr>
<tr>
<td>Leader encourages the company to implement ICGMs</td>
<td>0.916</td>
<td>22.681</td>
</tr>
<tr>
<td>Leader advocates integrity in management roles and strict ethical requirements</td>
<td>0.865</td>
<td>20.049</td>
</tr>
<tr>
<td>External description of all information is transparent and honest business advice is given</td>
<td>0.799</td>
<td>17.213</td>
</tr>
<tr>
<td>Management policies are implemented to avoid conflicts of interest for the leader</td>
<td>0.875</td>
<td>27.012</td>
</tr>
<tr>
<td>Shareholder rights ($\alpha$=0.909; CR=0.918; AVE=0.90)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No approval of material transactions without a majority vote at a shareholder meeting</td>
<td>0.848</td>
<td>24.123</td>
</tr>
<tr>
<td>Remuneration for directors and supervisors is determined at a meeting of shareholders</td>
<td>0.872</td>
<td>19.008</td>
</tr>
</tbody>
</table>
Details on the fairness and legitimacy of management remuneration and bonuses are disclosed 0.833 19.448
Details on employee salary, benefits, on-job training, pension plan, and company support of employee rights protection are disclosed 0.743 14.630
Insider trading and abusive self-dealing is prohibited 0.574 10.327
Disqualified directors should be removed from office by a resolution adopted at a meeting of shareholders 0.660 12.375
Implementation of major resolutions approved at the shareholder AGM 0.790 16.062
Annual dividend is fairly distributed among shareholders 0.818 17.031
Relevant and material information on the corporation disclosed in the annual report to shareholders 0.807 16.640
Leader secures the methods of ownership registration for shareholder rights 0.847 18.071

4.4. Structure model and results

The structure model used to test the hypotheses consisted of all four latent constructs. The test results for the proposed model are shown in Table 2 and Figure 1. For all structural path estimates, ethical spirit was positively linked to social responsibility (β=0.913, P<0.001) and ICGMs (β=0.420, P<0.001), but was not significantly linked to shareholder rights (β=0.027, P>0.05), in support of H1 and H2 but not of H3. In support of H4, social responsibility was positively linked to ICGMs (β=0.320, P<0.001). Finally, in support of H5 and H6, social responsibility (β=0.309, P<0.001) and ICGMs (β=0.487, P<0.001) were both positively linked to shareholder rights. Overall, five of the six proposed hypotheses tested using the structure model were supported.

<table>
<thead>
<tr>
<th>Relationship</th>
<th>Independent Variable</th>
<th>Dependent Variable</th>
<th>Standardized parameter estimate</th>
<th>t-value</th>
<th>Hypothesis</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethical spirit</td>
<td>Social responsibility</td>
<td>0.913</td>
<td>13.43</td>
<td>1</td>
<td>Supported</td>
<td></td>
</tr>
<tr>
<td>Ethical spirit</td>
<td>ICGMs</td>
<td>0.420</td>
<td>6.18</td>
<td>2</td>
<td>Supported</td>
<td></td>
</tr>
<tr>
<td>Ethical spirit</td>
<td>Shareholder rights</td>
<td>0.027</td>
<td>0.55</td>
<td>3</td>
<td>Not supported</td>
<td></td>
</tr>
<tr>
<td>Social responsibility</td>
<td>ICGMs</td>
<td>0.320</td>
<td>5.71</td>
<td>4</td>
<td>Supported</td>
<td></td>
</tr>
<tr>
<td>Social responsibility</td>
<td>Shareholder rights</td>
<td>0.309</td>
<td>7.19</td>
<td>5</td>
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<td></td>
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<tr>
<td>ICGMs</td>
<td>Shareholder rights</td>
<td>0.487</td>
<td>9.19</td>
<td>6</td>
<td>Supported</td>
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</tr>
</tbody>
</table>

***P<0.001

Figure 1. Results for the proposed model measurement model were internally consistent.
5. DISCUSSION

A survey of the literature on OECD principles for corporate governance revealed evidence suggesting that extension of the research approach to alter regulatory and legally structured will do much to improve ethical codes in business. Since modern laws and regulations hold little promise, prevention of corporate misconduct would benefit from a focus on ancient Chinese ethical codes. This process should be underpinned by legal protection for the leaders concerned. The corporate governance favored by national ethics codes should ideally reflect differences in corporate governance localization. In cases where such abuses are not specifically forbidden by legislation or where enforcement is not effective, it will be important to establish measures to remove such gaps in corporate governance. Shareholders rights are protected by mechanisms and more ethical virtues are useful to a firm, so shareholders are at less risk of being mistreated. As firms increase in size and scope, dispersed shareholders became more vulnerable and the need for shareholder protection increases. A simple balance of power is a very common approach for protecting shareholder rights. Additional shareholder rights, such as approval or election of auditors, direct nomination of board members, and ability to pledge shares and approval of the distribution of profits those are the norm in various jurisdictions. The equity component of compensation schemes for board members and employees should be subject to shareholder approval (Organisation for Economic Co-operation and Development, 2004). Shareholders should be able to communicate their views on the remuneration policy for board members and key executives.

According to Organisation for Economic Co-operation and Development (2004) principles, the board in turn is accountable to shareholder, who should be able to exercise their fundamental ownership rights to appoint board members, and should be treated equitably by the company. ICGMs are policies implemented by board of directors, audit committees, management, and other personnel to provide reasonable assurance that an entity will achieve its objectives in relation to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Shleifer and Vishny (1997) defined corporate governance as a mechanism to assure the deserved returns of shareholders, and to prevent internal directors, such as managers and controlling shareholders, from picking or wasting company resources. La Porta et al. (2000) concluded that the key role of corporate governance is protection of shareholders through a system of laws and enforcement of ethics codes. Effective corporate governance relies on both internal and external mechanisms (Cremers and Nair, 2005). An important function of stakeholders is to oversee the internal control systems covering financial reporting and the use of corporate assets and to guard against abusive transactions by related parties. In fulfilling these control responsibilities, it is important for the board to encourage the reporting of unethical or unlawful behavior. Greater transparency in corporate governance is needed for enterprises to control risk. Effective corporate governance protects dispersed shareholders against exploitative actions by unethical leaders. ICGMs provide a system that ensures that shareholders gain normal returns and against which the ethics code of leaders can be assessed.

In line with the Organisation for Economic Co-operation and Development (2004) principles, insider trading and abusive self-dealing should be prohibited. Abusive self-dealing occurs when individuals closely related to the company, including controlling shareholders, exploit this
relationship to the detriment of the company and investors. Holm and Scholer (2010) suggested that transparency and board independence are prime corporate governance mechanisms that are likely to reduce asymmetric information issues and thereby reduce agency problems. These practices constitute a breach of internal corporate mechanisms inasmuch as they violate the principle of equitable treatment of shareholders. Even though such practices are prohibited, enforcement is not vigorous in Taiwan. In terms of the governance environment, which is a set of political, economic and social institutions that facilitate or constrain the choices of governance mechanisms, China is more relation-based as it lacks a comprehensive rule of law (Li and Filer, 2007). Most shareholders have traditionally sought only financial returns on their investment and used this as the main parameter in evaluating leaders. Consideration of social responsibility benefits in investment strategies is not widely accepted, primarily because a firm’s efforts on environmental and social performance are considered as an expense that detracts from business profitability (Lo and Sheu, 2010). Hence, this stream of research suggests that property rights and, by implication, other forms of state regulation may affect the degree to which corporations behave in socially responsible ways (Campbell, 2007). However, an increasing number of shareholders are gaining awareness of the role of a firm’s social responsibility policies. For example, the annual growth rate for sustainability and ethical investments is up to 70% in Europe and North America. Ethical funds in the UK are worth between £50 billion and £100 billion, while socially screened funds are estimated to be worth US$2 trillion (Knoepfel, 2001). Global indexes, such as the FTSE4 Good Index and the Dow Jones Sustainability Group Indexes, measure the performance of companies that meet global corporate responsibility standards. The board is not only accountable to the company and its shareholders, but also has a duty to act in the best interests of society. Boards are expected to take due regard of, and deal fairly with, other stakeholder interests, including those of employees, creditors, customers, suppliers, local communities and society. Observance of environmental and social standards is relevant to board responsibilities (Organisation for Economic Co-operation and Development, 2004). Board members are also playing an increasingly important role in monitoring the social responsibility of leaders and, in some cases, pressing corporations to act in environmentally and socially responsible ways (Armour et al., 2003). Shareholders have recently mobilized to press corporate boards to act with greater more social responsibility. Institutional investors and financial intermediaries, such as controllers of pension funds and mutual funds, have become important economic actors controlling billions of dollars in investments.

Ethical leaders with sound social responsibility are a key element in the long term development of enterprises, whereas leaders with poor ethics will severely affect shareholder confidence and have a negative influence on the operation of enterprises. Ethical issues are often ambiguously defined and evaluations of ethical leadership are likely to depend on subjective perceptions of a leader’s character and motives (Trevino et al., 2003). An ethical leader is a key person in providing a structure through which the company objectives are set, and also offers a means of attaining these objectives and monitoring performance.

The study shows that for a common aim of improving the ethical spirit and social responsibility of leaders, the choice and ultimate design of ICGMs to protect shareholder rights depends on the overall research framework. An ethical leader complies with the structure and processes by which a company is directed and managed and management accountability is stressed.
to protect shareholder rights by enhancing ICGMs while taking into account the interests of other stakeholders. According to the Organisation for Economic Co-operation and Development (2004), business ethics and corporate awareness of environmental and societal interests of the communities in which a company operates can also have an impact on its reputation and its long-term success. Good ICGMs interact with shareholder rights in a timely and transparent manner in terms of monitoring a leader’s business conduct, establishing guidelines for the board, holding regular board meetings, and setting remuneration levels for directors and key staff. The study results prove that ICGMs controls for monitoring by the board of directors, with its legal authority to hire, fire and compensate top management, safeguard invested capital.

6. CONCLUSION

Our empirical results show that five of the hypotheses are supported, as shown in Table 2. SEM analysis methods were used to explore empirical data. According to the results, ethical spirit positively affects social responsibility and ICGMs, but has an indirect effect on shareholder rights. Social responsibility positively influences ICGMs.

Moreover, social responsibility and ICGMs play a significant role in shareholder rights. High ethical standards are in the long-term interests of a company as a means to credibility and trustworthiness, not only in day-to-day operations, but also with respect to longer-term commitments (Organisation for Economic Co-operation and Development, 2004). An overall framework for ethical spirit goes beyond compliance behavior, which should always be a fundamental requirement. Johnston (2004) noted that OECD efforts on corporate governance will also help in developing a culture of values for professional and ethical behavior on which well-functioning markets depend. Positive ICGMs can be used by ethical leaders to solve agency problems.

To date, too much of the debate on corporate governance has focused on legislative policy to deter fraudulent activities and a transparency policy, which misleads executives to treat the symptoms and not the cause (Gabrielle, 2003). Structural reforms of the type promoted by the corporate governance movement will do little to prevent the recurrence of widespread wrongdoing (Bragues, 2008). Thus, the aim of this study was to explore constructs of corporate governance using Daoism precepts on the ethical spirit of a leader. We conceptualized the viewpoint of stakeholders on empirical application of a new evaluation of the ethics and morality of Taiwanese leader.

According to the Organisation for Economic Co-operation and Development (2004), corporate governance objectives are also formulated in voluntary codes and standards that do not have legal status. While such codes play an important role in improving corporate governance arrangements, they might leave shareholders and other stakeholders with uncertainty concerning their status and implementation.

Hence, we identified 40 governance criteria for governance assessment that should be taken into account for effective enforcement, including the ability of leaders to deter dishonest behavior and to impose effective sanctions for violations. Using discriminant analysis of four constructs of the corporate governance, we presented and validated a concise model to explain ethical behavior.
differences in the use of corporate governance mechanisms in a given corporate governance system (Weir et al., 2002). Establishment of standard mechanisms to prevent internal control failures should be a general requirement. This study proves that the ethical spirit of a leader is negatively related to shareholder rights.

The OECD principles for corporate governance and company laws provide a solid context for individual shareholder rights. These require board members to act on a fully informed basis, in good faith, and with due diligence and care (Organisation for Economic Co-operation and Development, 2004). It has also been found that OECD programs and company laws for process or policies are successful in providing for fair shareholder investment. This is the main reason why leaders cannot address shareholder rights through standard regulations, OECD principles and local company laws.

While modern ICGMs have merits, particularly in terms of shareholder rights, integration of core ethical insights from ancient codes would be of benefit. This would provide a system for structuring, operating and controlling a company with a view to achieving long-term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and to complying with legal and regulatory requirements, apart from meeting environmental and local community needs.

This would require a greater emphasis on leader character and on instilling a sense of virtue in terms of the methods and power a leader uses in his managerial activities, as opposed to steering leaders using a mixture of laws, regulations, checks and balances.

Application of Daoism principles must suit modern commercial realities. This study proposes that Taiwanese leaders are motivated by a set of virtues articulated in the writings of Laozi. The study heeds the ancient virtues of Daoism, although this must be done with a view to the modern reality of complex commercial societies.

The study results also show that the ethical spirit of a leader has a significant positive relationship with ICGMs, but a weaker negative relationship with shareholder rights.

This means that workable ICGMs can be used by an ethical leader to alleviate negative selfish actions by providing internal control systems with appropriate audits and communicating with the board and treating shareholders fairly.

Stakeholders evaluate a leader’s insistence on establishing internal controls, politeness, sympathy, and willingness to recover from selfish failures. Thus, a leader should realize that good social responsibility and ICGMs can directly contribute to the success of shareholder rights.

REFERENCES


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