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Editorial

In a world and especially in academia where we can use the oxymoronic term “constantly changing” to define that thank change is a part of growth is illustrated in one of the articles presented in this journal regarding the change from 120 credit hours to 150 credit hours for accounting students as mandated by the AICPA. Another article highlighted succinctly how ethics plays a significant part in small business which is the engine of growth in any economy. This issue presents some very interesting papers.

Simon S.M. Yang, Allan S. Ashley and Jayen B. Patel of the Robert B. Willumstad School of Business Adelphi University in their paper “Performance of Best CEO Award Winners” examines whether a buy-and-hold investment strategy that invests in firms that are winners of the best CEO award (best CEO firms) yield, on average, a higher annual stock return than a matched sample of the marketplace. The study looks at the following two issues: The first issue involves the hypothesis that a stock investment in a firm led by an award winning best CEO yields, on average, a return higher than the market due to the CEO’s recognized leadership and performance in growing the company. The second issue involves the supposition that the higher than market stock returns for firms with a “best” CEO is volatile and unsustainable. The results suggest that with respect to stock returns, the CEOs most frequently selected as the best CEOs, on average, outperform new award winners. It appears that the selection of the best CEO firm is influenced more by the market expectation and public recognition and less by shareholders’ equity returns. This study also finds no evidence to support the supposition that investing in best CEO firms is more profitable than investing in companies whose CEOs have led their companies in achieving performance measures ranked in the top 25% of their industry. In conclusion, the study indicate that while the list of best CEOs is a useful investment reference tool, an investment betting on best CEOs is riskier than an investment in either a matched market firm or a firm that performs in the top 25% of its industry.

Asia Arli and Peng Chan from California State University-Fullerton and Lam Nguyen from Bloomsburg University in their article “Impact of Market Barriers on Choice of Entry Strategy into China” explores various barriers to entry to the Chinese market and identify preferred entry strategies shaped by those barriers. The study asked three questions: a) What are the main entry barriers into the Chinese market?; b) How do entry barriers influence the choice of the entry strategy?; and c) What entry strategies are used by foreign companies? The study reviewed the lack of integrity, supply chain risks, and corruption under the business barrier. It took a critical look at tastes and preferences and negotiation styles from a cultural perspective and the four traditional strategies to enter foreign markets: exporting, licensing, joint ventures, and direct investments. The investigation from a governmental standpoint targeted bureaucracy, restriction of foreign ownership in China and inconsistence of regulations across the country. The findings showed that market barriers influence the choice of the entry mode. In some cases, businesses did not have a choice due to the governmental restrictions to one entity type. In other cases, foreign companies altered traditional entry strategies according to the existing barriers. In conclusion, although China has become the center of great opportunities for both businesses and people and globalization and tough competition force companies to expand internationally further research recommendations include exploring wholly foreign owned enterprises in more details.

Nicholas Koumbiadis and R. Bruce Swensen from Adelphi University and Lam Nguyen from Bloomsburg University in their paper “The Road to Curriculum Change as a Result of the Mandated AICPA Requirement” examine whether the American Institute of Certified Public Accountants (AICPA)’s increased educational requirements for certification, from 120 to 150 credits, improve the quality of the accounting graduate. The study also examined whether a difference in ethical perceptions exists between newly graduated accounting students from the 120-credit program compared to those graduating from AICPA-mandated 150-credit programs at selected Association to Advance Collegiate Schools of Business (AACSB) accredited colleges in New York State. The findings indicate that the mean scores for the 150-credit program graduates are greater than the mean scores for the 120-credit program graduates for all variables, with the exception of the Social Responsibility variable. These results showing higher mean scores for the 150-credit program graduates support the CMD theory. The rationale explaining these results is the notion that a student progressing through the accounting curriculum from the 120-credit program to the 150-credit program
undergoes increased awareness of perceptions regarding ethical issues as a consequence of the increased credits. The results of this study demonstrate that the increase of thirty credits initiated by the AICPA has been associated with heightened ethical perceptions of those graduates who have taken the 150-credit program. In conclusion, the statistically significant results of this study are largely consistent with recent literature indicating that increased education may lead to improved awareness of ethical perceptions. There were also limitations to this study which include: use of a cross-sectional research design rather than a longitudinal design, the 286 accounting graduates participating in the study were randomly selected from a convenience sample of three nearby institutions, and the data were collected from self-reporting questionnaires.

M. Ruhul Amin from Bloomberg University in his paper “Ethics in Small Business: Toward a Conceptual Model” introduces a bold step toward theory building which will following next by the background leading to a conceptual theoretical model of small business ethics. This is done from the context that research on the ethics of the small business still seems timid, suffering neglect, and as if scholars have been waiting for theories /frameworks to emerge. The study established that small business ethics has been a neglected field although large portion of the economy of any nation depends the small business. It further indicated that with the IT revolution and proliferation of e-business, the scope of business fraud has been on the rapid rise. It was recognized that much of the business ethics literature within the constraint of philosophical debates on applied ethics has been limited to only large organizations and the small business sector has been ignored. A conceptual model was developed leading to five potential interrelated research statements. The model used contextual variables, ISO 26000SR- Standards of Ethical and Social Responsibility, and, Ethical/Unethical Behavior of the Enterprise and the Individual Employee with five illustrative cause-effect research statements. In conclusion, the author recognizes that more need to be done in terms of model specification and measurement of the variables. Also, this framework and the implicit causal model of small business ethics could be used for empirical studies leading to hypotheses testing in each of the five areas of the model.

The efforts to provide a journal with consistently high quality require the time and commitment from dedication individuals such as: authors, reviewers, technical editors, board members, and the managing editor. Kudos to everyone involved and with your continued support IJBAS will continue to be one of the leading journals for scholars.

Michael T. Hamlet, Ph.D.
Editor-in-Chief
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Ethics in Small Business:

Toward A Conceptual Model

M. Ruhul Amin
Bloomsburg University of Pennsylvania, USA

Introduction

The small business as the engine of economic development and employment has been widely recognized in all countries of the world. As such, favorable public policies and economic incentives for micro and small businesses provide impetus for further growth of small business enterprises in many countries. In addition, the rapid growth of digital economy during the 21st century with universal online transaction systems (PayPal and credit card payment system) has been contributing to rapid expansion of a new type of IT based international small business operations.

However, the proliferation of IT based digital business has not been an unmixed blessing to the society. Among the pitfalls, it did not only bring the issues of costly cyber security requirements, but also engendered new types of business frauds and fraudulent practices. According to a recent study by Price WaterhouseCooper (2009) of organizations worldwide, 30% of companies had been victims of an economic crime—fraud. A CNN-Money reports 25 million or 10% of the U.S. adult population have fallen victims of organized scams or fraud, and over $40 billion was lost from telemarketing scams alone in 2005. The National Fraud Intelligence Center in the U.K. received over 19000 reports of fraud within a matter of 4 days after founding of the Fraud Intelligence Center. Many country specific as well as organization specific Fraud Centers are in the offing to develop awareness of fraudulent business and scam activities.

In the editorial note of British Journal of Management, De Cremer, van Dick, Tenbrunsel, Pilluta and Murnighan (2011) while narrating the recent unending business scandals and instances of corruption, rightly stressed the fact that these events have also activated the general consciousness about ethics in general, and the business ethics in particular. As a consequence, a number of recent studies dealing with why unethical behavior and decision-making can emerge so easily despite the presence of multiple control and monitoring systems enriched the literature. A quick review of the current literature establish the following main currents: a normative-rational perspective (Trevino and Weaver, 1994; Adams et al., 2001; Weaver, 2001); an individual self- interest, greed based behavioral perspective; and contextual-cultural perspective (Singh, 2011; Murphy and Dacin, 2011; Duh, Belak and Mifelner, 2010; De Cremer, 2010; Tenbrunsel and Smith-Crowe, 2008; Tenbrunsel and Messick, 2004). However, in the wake of “invigorating” consciousness, research on the ethics of the small business still seems timid, suffering neglect, and as if scholars have been waiting for theories/frameworks to emerge. It is this context that this paper introduces a bold step toward theory building. What follows next is the background leading to a conceptual theoretical model of small business ethics.

In spite of periodic and sporadic calls for research and publications from various authors on ethics and ethical issues of small business, the scholars of business ethics continue to be preoccupied with top 1% of business organization in terms of size (Spence, 1999; Spence, Jeurissen and Rutherford, 2000; Prater and Gosh, 2005; Worthington, Ram, and Jones, 2006; Amin and Banerjee, 2006; 2008; Blodgett, Dumas and Zanzi, 2011)). In a provocative editorial, Spence and Rutherford (2003) stated,

“Failing to address ‘small business ethics’ is a fundamental flaw in the majority of business ethics research to date. In fact, our main concern is not simply that small firms need to be considered, but that business ethicists must acknowledge that the large multinational firm is not a standard business form against which other types are benchmarked” (p.4).
It has been recognized that Small businesses (by size) are different from the medium and large businesses on a number of dimensions. These include operational challenges, strategic issues and modes of operation. It is a matter of common understanding that all large businesses generally start as a small business, and while going through the life cycle, proliferate in size, complexity, hierarchy, and formalization. In addition, unlike the small business, large businesses tend to become more bureaucratic and decentralized. Spence (1999) lists uniqueness of small business operation with regards to: (a) owner-management, (b) independence, (c) multi-tasking, (d) “firefighting”, (e) personal relationship, (f) informality. Moreover, high mortality rate, chronic cash deficit, limited or no access to financial institutions (especially true for micro enterprises), diseconomy of scale, acute vulnerability to (i) rivalries (ii) new ventures, and (iii) the global competition also characterizes small businesses today. A continued pressure for survival, and bankruptcy avoidance as opposed to higher return on investment (Enderle, 2004) are often cited as deterministic hot spots of ethical infraction of the small business.

Cultural Context of Global Small Business

While there are similarities of experiences and challenges of the small business across nations, there are also culturally determined varied issues of business morals and informal practices on which they often differ. In addition, they vary on the issue intensity as well. For example, access to resources, positive/negative cash flow, high rate of business failures, ease of entry for new competitors, tax evasion are common issues of small business across cultures. However, corruptions, bribery, conflict of interest, harassment, extortion, piracy, copyright violation, forgery, counterfeiting, manipulation of weights and measures, and the like are generally the country specific ethical issues of small business. The intensity of such undesirable/unethical practices vary from country to country. For instance, in the U.S., some of the above issues have been dealt with the enactment and vigorous enforcement of legislation such as Sarbanes-Oxley Act; Affirmative Action; legislation prohibiting Sexual and Ethnic Harassment, Conflict of Interest principle; Lemon laws; Anti-Price Gouging legislation and the like. In spite of having a strong legal framework to deal with many of the ethical infractions and societal disapproval of unethical activity, a longitudinal survey (1985-2001) shows that one third of the U.S. firms with 100 and fewer employees reported ‘slight to extreme pressures’ to engage into unethical behavior during (1990s’) the Clinton era of growth. The more recent data (2001) shows a slight decline in the percentage, but it is still as high as 27% (Longenecker, et.al, 2006). The public perception of ethical behavior of small business has also continued to remain negative. In a national survey of business professionals, Vitell, Dickerson, and Festervand (2000) found that 50.3 percent indicated that the ethical standards of businesses were lower than they had been 10 years earlier; yet 65.2 percent indicated that ethical behavior had declined over the past 20 years.


In an empirical study done in India by Amin and Banerjee (2008), price gouging, cheating customers, counterfeiting goods, manipulating weights and measures, bribery, tax evasion (falsifying corporate income as well as sales, and value added taxes) were reportedly common among small and micro-businesses in India. They have also shown statistically significant associations of the corrupt practices with the type of ownership (single proprietorships, partnership and, limited liability corporations); with the industry sectors (manufacturing, service, education, IT); and the location of business (urban vs. rural).

The above review of literature establishes the following facts: (1) Small business is more pervasive and it operates differently compared to a large business. The scope, the propeller and the propensity for ethical/unethical conduct in the small business are greater than the large businesses. (2) The IT revolution has added a new dimension for ethical infractions and fraud i.e. the small businesses have become more vulnerable to IT fraud. (3) Cultural determinants for ethical infractions are too numerous than in the large business. (4) There are both institutional pressures as well as individual, personal factors contributing to ethical infractions in the small business. Based on the above facts, a conceptual framework (Model) has been proposed for clarity of understanding of small business ethic
Analytical Model of Small Business Ethics

Ethical Behavior-The Micro Perspective

To begin a serious study of Small Business Ethics, a philosophical basis and a framework is crucially needed. A theoretical framework needs to be developed that could enable both case studies and comparative studies of small business ethics. Theories and models explaining ethical business behavior have been very few and they have been offered mostly at the micro (individual) level. For instance, Uygur (2009) provides Islamic work ethic as an explanatory variable for the Turkish managers; Mark Blodgett et.al, (2011); Duh, Belak, and Milfelner (2010) offer family values as explanatory variable; Van Yperen et.al, (2011) attributes performance orientation explaining unethical behavior. In addition, Anne Barraquier (2011) provides four qualitative scenarios of ethical/non-ethical behavior based on legal compliance and ethical demands of the salient stakeholders in the flavors and fragrance industry of France. Her findings show that ethical behavior is determined by an intuitive process of tradeoff between profit making and ethical considerations. One of the decision outcomes of this process as she labels it, is "Fraud".

The model proposed in this paper uses the above perspective in the context of the existing philosophical debate on the applied ethics, and subscribes to the viewpoint (Rossouw, 2008) that an applied ethics should conform to the philosophical standards of Aristotle’s phronesis (prudence or practical knowledge) and that views variables of a specific situation within the context of the principles of individual and collective goods. It renders a judgment of right or wrong based on these principles and a directive based on the judgment leading to individual and or collective actions. This model also postulates an implicit causation of ethical infractions from a normative and individual behavioral approaches that balance ethicality and intentionality dimensions (De Cremer et.al, 2011; Tenbrunsel and Smith-Crowe, 2008).

Ethical Behavior -The Macro Perspective

Empirical studies dealing with ethical behavior at the organizational level are rarely seen in the realm of small business. The adoption ISO 26000SR, Standards of Ethics and Social Responsibility in 2010 by the International Standards Organization (ISO) has been a positive step forward toward measurement of organizational level ethical behavior. The proposed model incorporates these normative and voluntary compliance standards. Unlike ISO 9000 Standards (for quality) and ISO 14000 Standards, (Environmental Sustenance), ISO 26000SR does not include a mandatory compliance feature; it only includes normative standards of behavior and practices. We have used this normative standards as part of the proposed model.

Theoretical Framework of the Model

The theoretical causal model depicted below uses contextual variables, dimensions of business ethics under ISO 26000 SR, and the ethical/unethical behaviors of both the individual employees as well as organizations. By using these variables the following causal framework (Figure 1) has been proposed for the study of ethics in small business. It implies that: (1) contextual variables explain ethical/unethical behavior of the small business;(2) the contextual variables explain the ethical/unethical behavior of the individual employees; (3) the contextual variables affect organizational performance on the normative ISO 26000 SR Standards; (4) the contextual variables by mediating through normative ISO 26000SR contexts explain ethical/unethical behavior of the small business; and (5) the contextual variables by mediating through ISO 26000 SR Standards explain the ethical/unethical behavior of the employee. These five illustrative statements constitute the building block of the model.

Illustrative hypotheses could now be formulated based on each of the five statements above to gauge the ethicality of individual small business enterprises. The figure -1 therefore calls for aggressive and dedicated studies that must incorporate a robust measurement of variables. Toward this end, elements /variables of the analytical model has been defined next. Table-1 below attempts to list the specific variables for each of the four building blocks of the model. It may be noted here that while the literature support when available has
been provided, the author however does not claim that the list variables in each of the blocs is conclusive and exhaustive. More items could be added in each of the columns through empirical evidence, literature support, and comparative studies. For the sake of convenience of presenting, both organizational and employee behavioral parameters have been combined and presented under one column. The behavioral items are self-explanatory and may not need further definitions. They are left to researchers for accurate measurement and operationalization. However, in the interest of clarity, Contextual variables and normative Standards of ISO 26000 have been defined below to guide researchers intending to undertake scientific investigations.

Figure-1: Deterministic Framework of Ethical Behavior

Contextual Variables

Contextual variables are situational or contingency variables found to be associated or having potential to be associated with small business ethics as well as with individual ethical/unethical behaviors in the organization.

1. Age of the enterprise for instance, is a contingency variable. During the start up or birth stage, an entrepreneur tends to "fire fights", "multi-tasks" and often cut corners in order to survive. It is estimated that over 85% of all business start-ups file for bankruptcy during the first two years of existence. Issues of insufficient cash flow, constrained resources, and inexperience are generally the causes of small business failures during the early years (Amin and Banerjee, 2006; 2008). During such a stage, small businesses may be involved in cover-ups, price gouging, tax evasion; counterfeiting, fraud, lying to customers, and vendors.

2. Type of ownership has also been found to be associated with unethical practices. Research in group dynamics have already established that a group tends to make more conservative decisions and display more risk averse behavior relative to an individual. Likewise, a single proprietorship relative to a partnership and/or limited corporation tends to take greater risk and demonstrates more aggressive behaviors. In fact, Amin and Banerjee (2006; 2008) found significant association between the type of ownership and unethical business practices.

3. As reviewed in the literature (Amin and Banerjee, 2008), location of the enterprise has also been found to be associated with the unethical business practices. While urban location had the higher incidence of ethical infractions in Amin-Banerjee Study in India, this paper it a step further. It is a matter of common sense that if an enterprise is located in one of the most corrupt countries based on the Corruption Index of Transparency International (TI) of the world, higher incidence of advertent and inadvertent ethical infractions will be expected in the small businesses.
Furthermore, Serwinek (1992) found that ethical attitude tend to vary by regions of the country. Moreover, implicit in the literature on business strategy is that high intensity of competition and of rivalries among businesses may be associated with unfair business practices such as price gouging, and unfair pricing practices and negative advertisements to eliminate the rival entities.

4. Intensity of Competition and Intensity of Rivalry often to lead to unhealthy business practices such as price wars, illegal business espionage, and luring critical personnel of the competition with financial benefits and the like.

Table 1: Analytical Model of Small Business Ethics

<table>
<thead>
<tr>
<th>CONTEXTUAL VARIABLES</th>
<th>ISO 26000SR</th>
<th>UNETHICAL BEHAVIOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of the Enterprise</td>
<td>Organizational Governance</td>
<td>Padded Expense Account</td>
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<tr>
<td>Type of Ownership</td>
<td>Human Rights</td>
<td>Environmental Pollution (for cost)</td>
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<tr>
<td>Location of the Enterprise (Urban/Rural)</td>
<td>Human Resource (Labor) Practices</td>
<td>Faulty Investment Advice; Tax Evasion</td>
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<td>Foreign Business Payoff; Collusion in Bidding</td>
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<tr>
<td>Intensity of Competition</td>
<td>Environment</td>
<td>Enticing/Hiring Competitor's Key Employees</td>
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<tr>
<td>Intensity of Rivalry</td>
<td>Operating Practices</td>
<td>Insider Trading; Gifts to Purchase Agents</td>
</tr>
<tr>
<td>Pressure for Performance</td>
<td>Consumer Issues</td>
<td>Acquiescing in design flaw; Child Labor</td>
</tr>
<tr>
<td>Cultural/Ethical Climate</td>
<td>Community Involvement</td>
<td>Nepotism/Favoritism in Hiring and Promotion</td>
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<tr>
<td>Law and Legal Environment</td>
<td></td>
<td>Misleading Financial Reporting</td>
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<tr>
<td>Financial Conditions</td>
<td></td>
<td>Discrimination Against Women</td>
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<tr>
<td>Governmental Support and Incentives</td>
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<td>Discrimination Against Minority</td>
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<tr>
<td>Moral Orientation</td>
<td></td>
<td>Manipulation of Weights and Measures Misleading Advertisement</td>
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<tr>
<td>Personality Profile</td>
<td></td>
<td>Copyright violation (illegal copying of software)</td>
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<td></td>
<td></td>
<td>Counterfeiting /Adulteration</td>
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<td></td>
<td></td>
<td>Price Gauging; Bribery; Conflict of Interest</td>
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<td>Extortion (illegal subscription/surcharge)</td>
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<td></td>
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<td>Cover-up and Suppression of Truth</td>
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<td></td>
<td></td>
<td>Receive or Offer Kickbacks</td>
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<td></td>
<td></td>
<td>Invoice Fraud</td>
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<td></td>
<td></td>
<td>Sexual and/or Ethnic/Religious Harassment</td>
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<td></td>
<td></td>
<td>Hiring Illegal Workers</td>
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<td></td>
<td></td>
<td>Not Honoring Warranty</td>
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<tr>
<td></td>
<td></td>
<td>Lying to Customers, Vendors, Suppliers</td>
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<tr>
<td></td>
<td></td>
<td>Leaking Confidential Bidding Information</td>
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<tr>
<td></td>
<td></td>
<td>Working for a Competitor in disguise</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Stealing and/or Selling Business Secrets</td>
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Pressure for performance and incentives for performance excellence often lead to (individual as well as organizational) fraud, misleading financial and performance reporting behaviors. Systematic cover-ups of financial fraud at Enron, WorldCom, Tyco and the like, are only few examples of how pressures for performance could lead to unethical practices and organizational decline. Such a phenomena can only intensify in resource trapped small businesses. At the individual level, as Van Yperen, Hamstra and vander Klauw (2011) show, students with dominant performance-based goal demonstrated a stronger inclination to cheat. In addition, this author encountered numerous complaints about several small agencies of large investment firms giving faulty investment advice to clients (also confirmed by Longenecker et. al, 1989).

Business Culture and Ethical Climate is an important variable. Culture influences individual and organizational behavior. Business culture includes: norms, values, business strategies, operational strategies, human resource strategies, rules and standards, technology, compliance and control structures. Business culture inherits a great deal from the social culture. That is why every business culture is relative to economic, political, legal, moral structure and development of a society. Based on this postulate, the small business culture of the U.S. will be different from small business cultures of European, Asian, African, developing, and socialist countries of the world. On religious basis, businesses in Saudi Arabia generally operate in a climate of Islamic morality; businesses in the Western Europe and in the U.S. operate in a climate influenced by the protestant ethics. Similarly businesses in China operate under the socialist ethics. For instance, in a survey of entrepreneurs in China, this author found that most entrepreneurs do not see copyright violation as an ethical issue in view of the fact that such infractions allow individual income, and employment. In addition, within a particular culture, an ethical climate stems from the moral and religious orientations of the members of the society. In this regard, the general sociological literature affirms the notion that the degree of religiosity explains individual and family perceptions on a number of important dimensions.

Besides, in organizations that emphasize ethical principles, they tend have ethics code, policies dealing with misuse of power, harassment and the like governing the conduct of human resources. They also often adopt structural parameters in the form of Ethics Committee, Ethics Ombudsman, and an Ethical audit system.

Legal Environment of Business: Businesses operate in a specific legal environment. Beside the Common Law tradition, the small business in the U.S. operates under two dozens of Federal, State and Local government statutes. These relate to labor laws and laws relating to human resources, human rights, environmental protection, work place safety, health, and financial security of employees, customers, vendors, income and reporting protocols. In this context, both legal and ethical compliances are integrally combined. However, there are variations in the legal compliance requirements for small businesses across the globe. In addition, there are variations in the extent of enforcement of legal requirements across nations thus allowing rooms for manipulation, fraud, and corruption.

Financial Conditions: Enderle (2004) describes the plights of small business at the initial stage. A cash trapped business faces bankruptcy like condition in which legal and moral compliance could be stretched. In addition, a small business with access to wealth and resources may tradeoff compliance for additional profit. Moreover as Barraquier (2011) suggests, aggressive strategies for growth under stiff regulatory regime may also generate one of the following four decision outcomes: fraud, crisis, competition, and innovation.

Governmental Support and Incentives: Small businesses receive varying degrees of supports and incentives from the government in all countries. These supports and incentives especially help small businesses during the formative phase of operation. Firms receiving supports and incentives are often subjected to compliance reporting of applicable labor laws, laws pertaining to human resource management, and financial conditions. Such reporting requirements may often keep tendencies for unethical behavior at bay. However, access to governmental supports, incentives often are distributed through the alleged corrupt practices (i.e. briber; political favoritism) especially in the developing countries.

Moral Orientation of the Management: Morris et.al, (2002) identified several characteristics unique to small business, namely, cash reserve limitations, dependence on a small portfolio of product or services, difficulty in attaining dominance in the market, vulnerability in fluctuating demands, neglect by suppliers and distributors. They also claim that these characteristics encourage and often help the businesses justify ethical compromises. To work ethically under pressure of survival, a strong moral orientation of the small business is expected. In the absence of such an orientation, ethical infractions are more likely to happen. Duh et.al,
(2010) showed that family core values contribute to ethical culture and climate. In addition, Walker, Smither, DeBode (2012) assert that religious orientation of people correlate with positive ethical attitudes.

11. Personality Profile: Individual entrepreneurs vary in terms of personality, values, preferences and modes of operation. Entrepreneurs are generally characterized by the needs of achievement (McClelland, 1961). Obsession with achievement could negatively impact ethical conduct and therefore selection of priorities. Individuals also vary in terms of self-interest and personal ego. These characteristics may often lead to compromising situations of profit vs. moral imperatives. In addition, studies dealing with Machiavellianism which stipulates a willingness to influence others for personal gain may be useful in this context. King and Roberts (1992) asserted that entrepreneurs often demonstrate tendencies of a master manipulator. Moreover Trevino (1986) proposed a "person-situation interactionist" model which supposedly explains the ethical decision making scenarios. According to this model, personal variables such as cognitive moral development, ego strength, locus of control (internal/external) do interact with situational factors such as organizational reward structure to influence ethical decision making behavior.

ISO 26000SR: Normative Principles of Ethics and Social Responsibility

While contextual variables are independent variables of the ISO 26000SR is a set of dependent variables. Based on the proposed model, the contextual variables are expected to explain the variations in the items of ISO 26000SR.

ISO 26000SR is a set of a voluntary guidance standards on ethics and social responsibility for business enterprises. It was designed to be used by any organization, large or small. Unlike ISO 9000 (quality control) and 14000 (environmental management system), ISO 26000SR was not developed for certification purposes. The key elements of the standards include Stakeholders, Core Subjects processes, and Reporting. Communicating with the stakeholders (i.e. workers, suppliers, members of the community, consumers, and investors) on how the organization addresses seven core subject areas such as governance, human rights, labor practices, environment, fair operating practices, consumer issues, and the community involvement and development. The reports that come out identify what an organization has been doing in its current practices, and what priorities are being set as a part of continuous improvement of program pertaining to the seven core subject areas. A brief definition of the core subject areas as adopted by ISO are provided below:

1. Organizational Governance

This involves accountability (decision makers take responsibility for their actions), transparency (openness in explaining how decisions are made; how it handles money, and the like) at all levels of organizational hierarchy. This also addresses how leadership creates a culture of ethical decision-making (treating others with honesty and fairness, consideration of stakeholders' interest, and obeying the laws) with social responsibility as its core value.

2. Human Rights

Human Rights in the ISO 26000SR standards generally refer to recognizing and treating all individuals with respect and fairness regardless of gender, ethnicity, sexual orientation, national origin, and disability with respect and fairness. This also addresses processes of conflict resolution, resolving grievances, and calls for respecting civil, political, economic, social, religious rights; and safeguarding freedoms of expression, assembly, rights to information, health, food, education, safety and security. Proactively helping the most vulnerable groups of a society through such programs as Equal Opportunity, and Affirmative Action programs are implicit in this core subject area.

3. Labor Practices

Fair and ethical labor practices such as providing a just, safe, and healthy environment to all labor (permanent/temporary) and the provision of a fair labor contract that ensures the rights of collective bargaining are envisaged in the standards. It also includes fairness in hiring, firing, promotion, performance appraisal, training, and wage/salary administration. Implicit in this subject area are conditions of work, work hours, overtime, occupational safety, and prohibition of child labor practices.
4. Environment

Business should make commitments for identifying and improving environmental impacts of operation, including resource use and waste disposal are covered in this subject area. It also stresses the adherence to the principle that ‘businesses have the responsibility to act to reduce damage to the environment and to improve conditions of air, soil, water, and ecosystems’. Therefore in this regard, they should adopt the following moral imperatives: accept responsibility of environmental degradation caused by the operation; take precautionary measures when faced with threats to environment; implement environmental risk management programs for operation, products and services; and adhere to the principle of ‘polluter pays’.

5. Fair Operating Practices

Under this subject area, adherence to the rule of law, accountability, transparency, and honesty are the recommended principles that should govern operating practices of an enterprise. In addition, respecting property rights, rights of other businesses, including competitors should be fully recognized in the operational system. Moreover, bribery, undue influence, and abuse of power should have no room in the operative procedures.

6. Consumer Issues

Included in the above subject area is the recognition that businesses have moral obligations to their consumers. Principles and activities such as truthful advertising, providing beneficial products and services (with health hazards and side effects completely disclosed) to the consumers, provision of helpful user guides, warranty, a refund guarantee if not satisfied by the consumer, trouble-shooting helps, and easy recall procedures --all should be incorporated in the customer relations practices of the enterprise.

7. Community Involvement and Development

It is the moral obligation of the business to recognize and contribute to the long term interest of the communities in which they operate. Subject to ability to do so, investment in the infrastructures, recreational facilities, philanthropic activities such as grants, donations to the community specific charities, assistance to employment generation, health and education programs are to be desirable and moral imperatives for the enterprise.

Behavioral Dimensions of the Model

As reported in table 1, column 3, a combined list of organizational and individual behaviors has been presented. They were combined mainly because some of the unethical behaviors listed, fall under both individual as well as organizational categories. Each of the item on the list is self- explanatory. It will therefore be up to the future researchers to select all or some of these behaviors, and measure them both at individual and organizational levels. It should be noted here that some of these behaviors were derived from literature reviewed in the paper, and some of them were derived from personal interviews of small business entrepreneurs in India, Bangladesh and China as a part of author's research on the topic.

Conclusion

We have noted in this paper that although the rate is decreasing, the negative perception of ethical behavior of small business still persists (Vitell, Dickerson, Festervand, 2000; Longenecker, et al, 2006). We also established that small business ethics has been a neglected field although large portion of the economy of any nation depends the small business. We have further established that with IT revolution and proliferation of e-business, the scope of business fraud has been on the rapid rise. In addition, we have recognized that much of the business ethics literature within the constraint of philosophical debates on applied ethics has been limited to only large organizations and the small business sector has been ignored. Within the limited growth of literature in the small business ethics, this author notes that neither philosophical nor epistemological discourses have taken root in the area of small business ethics. It is in this context that this paper attempts to provide a theoretical framework with Aristotelian philosophy of applied ethics.

A conceptual model was developed leading to five potential interrelated research statements. The model used contextual variables, ISO 26000SR- Standards of Ethical and Social Responsibility, and, Ethical/Unethical
Behavior of the Enterprise and the Individual Employee: The five illustrative cause-effect research statements include: (1) that the contextual variables explain ethical/unethical behavior of the small business; (2) that the contextual variables explain the ethical/unethical behavior of the individual employees; (3) that the contextual variables affect organizational performance on the normative ISO 26000 SR Standards; (4) that the contextual variables by mediating through normative ISO 26000SR Standards explain the ethical/unethical behavior of the small business; and (5) that the contextual variables by mediating through ISO 26000SR explain the ethical/unethical behavior of the employee.

The theoretical framework was explained and conceptual definitions of all elements of the model have been provided in the paper. The author recognizes that a lot has to be done in terms of model specification, and the measurement of the variables. However, the author believes that this framework and the implicit causal model of small business ethics could be used for empirical studies leading to hypotheses testing in each of the five areas of the model. It is expected that the proposed model shall provide impetus for comparative study of small business ethics. Discussion, debates with any or all aspects of the model will only strengthen the literature of small business ethics.
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Impact of Market Barriers on Choice of Entry Strategy into China

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ABSTRACT

China is considered to be the most attractive and dynamically developing market. China’s economy keeps growing in spite of world’s downturn. Consequently, growing potential tempts foreign investors to enter Chinese market. Exporting, franchising, joint ventures and fully owned companies are the most popular entry modes. However, the choice of the entry strategy is affected by numerous market barriers, including business, cultural, governmental and other limitations. Exploring existing barriers is a crucial factor in identifying the right strategy. The originality of this paper involves examining the influence of the existing market barriers on the choice of the entry strategy in China.

KEYWORDS: Market entry barriers; Entry strategies; China

Introduction

The world of opportunities has gradually moved from West to East. China has become an attractive market and a manufacturing center for foreign companies. When China opened its door in 1979, first movers were subject to strict regulations and restrictions (Lieberthal & Lieberthal, 2003). Gradually, Red Dragon has relaxed some of its regulations, as an effect, the number of foreign companies entering the market has also increased. Joining World Trade Organization was one of the turning points in the development of the international relationships between China and the world. China’s dynamic market has tempted many foreign companies to do business in the country. Even when the world’s economy was in downturn, China’s impressive GDP was 8.7 percent in 2009 (The US-China Business Council, 2010).

Foreign companies face a number of barriers on the way to do business in China. Nevertheless, exploring market barriers would help to identify the right entry strategy and foresee potential problems. Market barriers include business, cultural, governmental and other limitations. For instance, some companies are restricted to only one entity type that is supposed to protect domestic companies. As a result, the main problem addressed in this paper is choosing the right entry strategy to overcome barriers imposed by Chinese market environment.
The purpose of this study is to explore various barriers to entry Chinese market and identify preferred entry strategies shaped by those barriers. Specific research questions include: a) What are the main entry barriers into the Chinese market?; b) How do entry barriers influence the choice of the entry strategy?; and c) What entry strategies are used by foreign companies?

**Business Barriers**

Exploring Chinese market might be very tempting from the first sight but deeper analysis reveals many ‘underwater stones’ on the way to success. Three main issues in the business field are lack of integrity, supply chain risks, and corruption.

**Lack of Integrity**

The roots of poor integrity level in China derive from its culture and history. As Graham and Lam (2003) have noted for many years, China was a subject of external attacks and internal civil wars. As a result, the Chinese are quite negligent to the laws and regulations. They mainly believe in families and ‘cash’ (Graham & Lam, 2003). A number of law violations occur in many companies primarily run by Chinese managers. According to Deloitte research (2007), potential M&A target companies in China were passing false documents, registering fake companies and assets in order to enjoy the benefits of a start-up company, making false payments and transferring cash to their officers’ personal bank accounts. The possible ways to improve the situation are strict internal and external control. Companies should create internal audit that would randomly examine documents and decisions made. The external control involves screening potential suppliers, partners and employees. However, it might turn out to be costly for the company to examine each partner and employee. In addition, it is very hard to track the actions of the suppliers, since most of them lack transparency. It is well known that some deals are sealed under the table.

**Supply Chain Risks**

Although, China is a very popular manufacturing location, companies struggle with a number of supply chain risks. The dominant problem is intellectual property infringement that represents fifty nine percent in comparison to the United States’ four percent (O’Marah, 2009, Figure 1). According to the discussion conducted in a marketing class, about ninety percent of the respondents buy counterfeits from China and some of them even prefer to buy them. The major reasoning was lower prices for the products with the quality close to the originals. One of the participants pointed out that some companies that manufacture counterfeits make significant product improvements.

How can fake products be recognized? Sometimes, it is hard to tell the difference between fake and original products. ‘Fake rivals’ can slightly change logo, color or shape and start manufacturing it as a new product. For example, they print ‘ABIBAS’ instead of ‘ADIDAS’ or ‘NOKLA’ instead of ‘NOKIA’. The list of imitated names is endless. One can question legal protection in China. Certainly, companies can register their patents and trademarks (U.S. Department of Commerce, 2003). However, Chinese companies still produce fake products violating the law. Thus, if company’s success heavily relies on patents and trademarks, potential profit from Chinese market might not be worth the risk (O’Marah, 2009).

Manufacturers of counterfeits do not greatly invest in fixed assets. Most of the fake products come from the basements and garages. In addition, companies employ low skilled labor that results in labor cost savings. Thus, even if legal prosecutors detect and eliminate one of the fake product manufacturers, the same entrepreneur would open another company in a different location. Why do they continue producing counterfeits? Chinese fake product manufacturers do not incur costs of developing and promoting the products. They just fill in the demand of the already existing market.

Moreover, other major risks are supply product quality failures and internal product quality failures (Figure1). One of most laudable scandals of the last decade is the recall of toys in 2007. Mattel, Inc recalled 20 millions toys made in China from countries all over the world due to the hazardous chemicals and toxins contained in the coating. Further investigation revealed that one of the Mattel’s subcontractors failed to maintain the quality
of the materials used (CNN.com, 2007). In this case, external failure to control quality standards was catastrophic for the whole value chain.

Massive recalls and compensation programs lead to profit losses and damaged goodwill. These types of failures have long term consequences, such as decreased sales, lawsuits and increased expenses on public relations and community involvements. The most efficient way to recover is to admit the mistake and take actions to fix it. The whole supply-distribution system is paralyzed for a while, causing additional financial losses. As a result, reliability of supply chain might be a key success factor. External and internal quality failures may lead to millions of dollars in revenue losses and damaged reputation.

Corruption

Corruption is another barrier faced by foreign companies planning to enter Chinese market. According to Transparency International report (2012), corruption perception index in China is 39 out of 100 points. China is ranked 80 out of 176 countries and territories in the world. Among Asia-Pacific countries, China is ranked 12 out of 28 countries. This suggests that China is experiencing significant corruption problems. Gift giving and donations are used to open doors in China. Processing documents and getting business licenses might take substantial amount of time without ‘treats’ (Pedersen & Wu, 2006). Employing personal contacts and relationships (guanxi) is the most effective way to get things done. However, the flip side of this practice is that foreign companies must comply with their anticorruption laws. For instance, Sarbanes-Oxley Act, U.S. Foreign Corruption Practices Act and other strict regulations are imposed on U.S. companies. Violations have negative consequences on the company’s image and budget (Gross, Cross & Blank, 2008). Thus, the companies might put themselves between two fires: getting things done or complying with the law.

Coca-Cola Company found a smart way to incorporate guanxi into its strategy avoiding corruption violations. As Yan (1998) has noted, Coca-Cola established joint ventures with three important players on the Chinese market- China International Trust and Investment Corporation, Kerry Group and Swire Pacific. All three partners had extensive connections with government officials and businesspeople. As Coca-Cola’s partners, they were involved in all sorts of negotiations with officials, suppliers and other stakeholders (Yan, 1998). As a result, Coca-Cola strengthened its position on the market by employing personal connections of its partners.

Cultural Barriers

Cultural issues are other challenges of starting business in China. Culture has strong and deep roots in minds of Chinese people. This legacy has been passing from generation to generation for thousands of years. Chinese culture is unique and different from other cultures. However, it is also diversified across the country. Various dialects might also lead to misunderstanding. For instance, sometimes, citizens of one province cannot understand the dialect of another province. Traditions and ceremonies might also be quite different. Thus, potential investors should be aware of the need to adapt an entry strategy according to the cultural preferences and differences.

Tastes and Preferences

Diversity of tastes is a challenge for the companies in the food industry. National cuisine and life style identify taste preferences. For instance, the Chinese give preferences to fresh fruits and vegetables. The majority of the population performs heavy physical work. Thus, they consume heavy food instead of sandwiches and snacks. Dairy products do not play a significant role in Chinese diet. Therefore, dairy product producers have to build a market or demand by creating an image of healthy products. As a result, analyzing customers’ tastes helps to identify the strategy of conquering the market.

Coca-Cola Company created a market for its products in China, even though they were not welcomed in the beginning. According to Yan (1998), Coca-Cola was one of the first movers to China. It might seem to be easy for a multinational company to expand to new markets. However, the process of getting into Chinese market was quite harsh. Coca-Cola entered Red Dragon in 1981. But, color and taste provoked customers’ resistance to the product. Chinese people were accustomed to fruit flavored and light colored drinks. In addition, Coca-Cola’s taste resembled Chinese herb remedies. As a result, Coca-Cola focused on promoting Fanta and Sprite. By the end of the first year, Sprite sales exceeded Coke ones (Yan, 1998). Nevertheless, customers were gradually switching preference to Coke. Nowadays, Coke is one of the most popular soft drinks in China.
Knowing consumers’ preferences is another crucial aspect of business success. For instance, Yan (1998) pointed out that U.S. second brewing company Miller entered Chinese market with their premium beer in 1992, almost 3 years before its rival, Budweiser owned by U.S company, Anheuser-Busch. In comparison to Miller, Budweiser did its homework and researched the market. The analysis showed that 70 percent of premium beer was consumed at restaurants and 30 percent at homes. Customers were ordering premium brand beer at the restaurants to “save face” in front of their friends, relatives and colleagues. In addition, Budweiser premium beer was filled in glass bottles that were four times cheaper to manufacture than tin cans due to the lack of aluminum resources in China. In contrast, Miller continued to distribute its premium beer in tin cans. As a result, Miller ceased its operations in 1994 (Yan, 1998).

**Negotiating Style**

Ramey (2008) has emphasized that negotiating style in China can be quite confusing for U.S. investors. First of all, Chinese businesspeople prefer to use the first couple of meetings to get to know their future partners. Those long meetings might seem unproductive and inefficient for U.S. business partners (Ramey, 2008). However, building good and close relationships with partners is a key success factor of doing business in China. Moreover, none of the American deals would be sealed without zhongjian ren, the intermediary (Graham & Lam, 2003). Since an intermediary can blur cultural and language barriers, then it is easier to settle the deal with Chinese businesspeople.

Graham and Lam (2003) gave an example of U.S. businessperson who travelled to China to negotiate terms of an R&D contract. The first couple of meetings went smooth, however later on American and Chinese representatives got into an argument over the ownership of intellectual property. When the conflict reached its climax, Chinese partner decided to save his face and left. Afterwards, the U.S. partner hired an intermediary to settle the deal. Thus, the conflict was magically resolved and the papers were signed (Graham & Lam, 2003).

Intermediary’s goal is to bring both sides to an agreement. The differences in negotiating styles build barriers in achieving the consensus. American businesspeople prefer direct communication, but Chinese counterparts prefer indirect communication. Furthermore, U.S. partners jump straight to the point, Chinese businesspeople move in circles gradually approaching the main point. Even when the papers are signed, Chinese partners, who focus more on the process rather than on the result, tend to continue negotiations (Ramey, 2008). Thus, negotiating with Chinese partners is an ongoing process that never ends.

**Governmental Barriers**

The main role of the government is to protect domestic companies from the foreign ‘invaders’. The government employs trade policies, regulations and laws to reduce the competition from the outsiders. Thus, international companies are usually subject to quotas, tariffs, business licenses and government contracts. Chinese government usually pursues two goals: protection and development. How will the country benefit from letting each foreign country to entry the market? Some foreign investors bring experience, technology and even ‘brains’ to the Chinese market. China has recently become a land of opportunities. Therefore, many students graduated from all over the world plan to pursue their careers in the country of Red Dragon.

**Bureaucracy**

When we hear socialist market structure, we automatically build the connection to the bureaucracy. The term implies centralized economy where decisions are made at the top. The main disadvantage of this market structure is a lack of flexibility. In addition, socialism creates a favorable soil for corruption. Getting official papers done requires patience from the side of businesspeople. It becomes a nightmare for U.S. investors who are used to prompt responses. Registering a business involves getting business licenses, permissions, and other documents, that have to be carefully examined and signed by different public officials.

**Restriction of Foreign Ownership in China**

First movers usually ‘test the water’, that might be two-folded. On the one hand, they are first to seize the market and harvest the revenues. On the other hand, they have to create the market or need and deal with
unpredictable emergencies. Unfamiliar market is always full of surprises. In addition, when China first opened its door in 1979, the government imposed entity type, location and industry restrictions on foreign investors (Lieberthal & Lieberthal, 2003). Yan (1998) mentioned courier sector in China, the newcomers like UPS, FedEx, DHL and TNT were restricted to one representative, Sinotrans. As a result, competitive advantages faded. However, in 1980 the government permitted U.S. companies to form fifty-fifty joint ventures with Sinotrans. All companies rushed into new relationships except FedEx. FedEx preferred to have Sinotrans as an agent and gradually switched to another agent (Yan, 1998).

Limiting companies to create joint ventures with domestic companies enables exchange of experience that might be quite favorable for both sides. On the one hand, foreign companies could learn how the business is done in China and domestic companies could gain some oversea managerial experience. On the other hand, joint ventures imply sharing of control that might become an issue. For instance, Unilever failed to integrate the distribution system of its six joint ventures, because it had to negotiate with each partner who did not welcome the idea (Wildfried, 2000). In worst cases, disagreements over marketing strategy and business operations might lead to dissolution of a joint venture contract.

**Inconsistence of Regulations across the Country**

Similar to the United States, regulations and laws vary from province to province in China. Therefore, companies operating across the country have to deal with those discrepancies. For instance, when Carlsberg was planning to manufacture its promotional mugs, it found out about the regulations requiring determining the volume of mugs; however, the problem was in different measurement standards used by provinces (Fox, 1998). As a result, different regulations create barriers to target the whole Chinese market. Market segmentation, procedure modifications and negotiations with officials take place to overcome these barriers.

**Other Barriers**

**Locations**

Choosing the right location is another challenge of starting business in China. Red Dragon has the fourth biggest territory in the world. However, China is mainly developed around big cities and coast line. Some remote inland provinces are quite poor and less developed. It can be said that some parts of the country have entered the twenty first century and other areas are still trying to break out of the twentieth century. The major factors that determine a business location are infrastructure and availability of labor resources. Even though, Chinese government makes attempts to improve road conditions, some areas still lack accessibility. Another problem with remote locations is a lack of talented management. Ongoing operations must be monitored and controlled, however it is hard to attract professionals to remote inland locations.

Remote location might also create the problem of accessibility to the customers or target market. Fox (1998) mentions that customers’ incomes also vary according to the place of living. Guangzhou took the first place in family earnings and the fourth place in spending out of 12 biggest cities in China. Beijing was recognized as the third wealthiest city after Shanghai (Fox, 1998). Right location is the key element of the entry strategy. For instance, McDonald’s key expansion strategy is choosing the best location. Pr. Broyles, a marketing instructor at California State University of Fullerton, mentioned that when McDonalds was planning on entering Chinese market, the company carefully examined all places in the city. The analysts chose the building that was occupied by municipal officials at that time. Thus, McDonald’s decided to suspend the expansion until they got the building a few years later.

**Human Resources**

China attracts foreign investors by offering a huge labor pool. However, companies searching for the skilled labor might encounter difficulties to find workers. Beamish (2006) reported that even General Electrics admitted the need for top and middle level managers in China. In addition, in case of L’Oreal, college graduates kept switching employers in search of better positions and salaries (Beamish, 2006). Thus, the pool of available labor force is not as huge as it seems from the first sight. The level of skilled and educated people is still not high in China. The overall development of the Chinese population leaves much to be desired. According to Allen (2010), approximately 50 million Chinese live in the twenty first century, 300 million people make their way through the twenty first century and over 80 percent of the population tries to survive in the late nineteenth
century. Therefore, the majority of the people are still trying to catch up to the rest of the world. As a result, potential investors should also consider the quality of the labor resources.

**Strategies for Entering the Chinese Market**

Tough competition and globalization force companies to go international. However, what market to enter, how to enter the market, when to enter the market are the crucial questions that must be considered. Perfect timing and right entry strategy are key success factors on the entry level. There are four traditional strategies to enter foreign markets: exporting, licensing, joint ventures, and direct investments.

**Exporting**

Exporting is the cheapest way to enter new markets. The most important thing is to build an effective distribution network. However, China’s logistic system is in a very bad shape. As one of the businessmen has mentioned, Chinese logistics is comprised by local truck owners who focus more on the price rather than on the quality of the services provided. Poor services result in damaged goods and revenue losses. Lack of strong insurance policies signifies the risk involved. The best exporting customer in China is the government that takes care of the merchandise.

Furthermore, the US-China Business Council reports that in 2009 China’s import with the world was 1,005 billion dollars. The top three importing commodities are “electrical machinery and equipment, mineral fuel and oil, and power generation equipment.” In addition, the majority of the imports come from Japan, South Korea and Taiwan (The US-China Business Council, 2010). Japan and South Korea have world’s recognition in the technology field. They develop and produce the most modern electronic equipment. Thus, China tends to import technologies and natural resources.

**Franchising**

Franchising is a contract between franchisor and franchisee, where franchisor grants franchisee a permission to open the same business under certain restrictions and standards. In return, franchisee is obliged to pay franchising fee and comply with all standard forced by a franchisor. Both parties benefit from this type of the contract. On one hand, franchisor expands its distribution network. On the other hand, franchisee enjoys an already established image of the company. As it was mentioned in the article written by Malozzi (2010), franchising is in the booming stage in China. According to franchising contract, franchisees must provide the services or produce goods of the same quality. Franchising is a widely spread expansion tool in the food industry. U.S. companies like Kentucky Fried Chicken, McDonald’s and Mr. Softee enjoy doing business in the country of Red Dragon. However, each of the companies made some changes to adapt to the local market. Thompson, Strickland, and Gamble. (2010) described the adjusting process of KFC in China. First, the menu was slightly changed to meet local tastes and preferences. Second, the company was constantly upgrading its menu. Third, the internal design of the restaurants was aimed to attract families. Surprisingly, KFC is one of the most popular places to celebrate birthdays in China (Thompson, Strickland & Gamble, 2010). In contrast, American people would rarely invite their friends and relatives to throw a birthday party at KFC. Chinese perception of KFC as a family restaurant comes from the culture. Traditional Chinese restaurants are places to eat and go. Customers do not usually stay there for a while and enjoy their time with their friends and relatives. However, KFC differentiated itself from other local restaurants by creating a family oriented image.

According to Mallozi (2010), Mr. Softee has also adapted its operations on the way to the Chinese market. Through offering free samples, ice cream tastes were adopted to the local preferences. In order to maintain the same quality and flavor, the company decided to import milk, the main ingredient, from the United States. In addition, Mr. Softee had a hard time to train its drivers, who were supposed to drive company’s eye catching vans carefully and slowly (Mallozi, 2010). The roads are loaded with cars; every driver tries to squeeze into a long and endless line. Thus, training drivers must have been a painful process for Mr. Softee.

**Joint Ventures**

Joint venture is the most widely spread entry strategy into Chinese market. According to Sinha (2009), foreign direct investments into China reached 82 billion dollars in 2008, in contrast to Indian’s 46 billion dollars. How did China end up attracting so many foreign investors? Chinese government has been working hard on
improving inland infrastructure and developing incentive policies, such as preferential taxes, relaxed labor laws, 100 percent ownership of the subsidiaries by foreign investors (Sinha, 2009). All these developments contributed to increased inflow of foreign direct investments. The shortcoming of this entry mode is sharing of control. Partners must negotiate all nuances of business operations. For instance, Lucent, producer of the optical equipment, lost 40 percent of its market share because every product change was required to be approved by the partner (Wilfried, 2000). Thus, joint ventures cannot make decisions promptly; getting partners’ consensus usually takes time that leads to business inefficiency and lack of flexibility. However, flexibility is one of the crucial factors on the Chinese market.

Currently, Chinese market is in the transitional state. Business environment keeps changing so rapidly that some companies cannot quickly respond to the occurred transformations. Operating flexibility plays a very important role in this case. If international companies are burdened with inefficient negotiations with their Chinese partners, they would have hard time to make necessary adjustments without losing market share and customers. In addition, the number of foreign companies entering the market is constantly growing every year. Thus, the competitive environment becomes more aggressive.

In some cases, joint venture is the only available entity type to enter certain Chinese industries or sectors. Wilfried (1997) provided an example of unsuccessful joint venture between U.S. household product company and Shanghai Jahwa Corporation. This alliance was beneficial for the both parties. Jahwa provided personal connections with municipal officials and other business leaders. In return, it wanted American company to upgrade its technology and enhance managerial performance. However, companies got into the argument over the strategy and distribution of resources. As a result, Jahwa transferred its ownership to another Chinese company, leaving the U.S. company to make its way through (Wilfried, 1997). Thus, foreign companies should take into account the dreams of their potential partners.

Searching for the right partner is another issue for the foreign companies. According to Pranee (2009), the key components of successful partnership are common standards and values, reliability, trust and communication. Obviously, companies would have to bring together their corporate standards and values. In addition, U.S. investors tend to trust their partners, unless they give a reason not to. In contrast, Chinese partners are very suspicious, from their point of view, trust must be earned. Reliability is a very important factor in all forms of business relationships (Pranee, 2009). For example, Walmart’s success is built on its supply and distribution systems. As Pr. Broyles has commented, every supplier knows the exact time when they can approach the gate to deliver the merchandise. There is only a thirty second window to delay the delivery. If a supplier is constantly late, he/she ruins the whole supply systems. Thus, this supplier is not reliable and would probably lose the contract.

Moreover, language barriers create a misunderstanding between partners. Attracting interpreters would ease the problem. However, the shortcoming of interpreters is their unfamiliarity with the business and all processes involved. Thus, the best solution is to attract managers who were educated overseas and quite fluent in both languages. The combination of trust, reliability and effective communication creates a favorable environment for running a successful joint venture. Partners must operate as a whole unity.

**Wholly Foreign Owned Enterprise**

Wholly foreign owned enterprise (WFOE) is another widely used entry mode. The main advantage of this strategy is the full control that goes along with a high level of risk. The limitation of this entry mode is negotiating difficulties with municipal representatives and other business players. Cultural and language barriers worsen the situation. Thus, many companies prefer to enter the market the first time utilizing a joint venture mode. After establishing some personal contacts and adapting to the local market, a company can transform from a partnership entity type to a full ownership.

Wilfried (1997) gave an example of Johnson & Johnson that decided to introduce its new product lines to the Chinese in 1992. Instead of establishing a joint venture, the company went with wholly foreign owned enterprise. The main reasoning was retaining managerial control. The results were impressive – two years later, sales were growing by 40-50 percent every year (Wilfried, 1997). In this particular case, Johnson & Johnson had a prior experience of entering Chinese market through establishing joint ventures. Consequently, the company was quite experienced in operating in China. Thus, Johnson & Johnson secured the success of its wholly owned enterprise.
Getting in Through the Back Door

Some companies have to adjust traditional entry modes according to the specific government, industry or sector requirements. Joint ventures and wholly foreign owned enterprises are subject to a trade-off between risk and control. Thus, increased control power implies higher risks. At the same time, the entry mode should be consistent with the company’s long term strategy. As a result, some companies prefer to alter traditional entry strategies and get in through the ‘back door’.

In one of the marketing classes, Pr. Broyles discussed Coca-Cola’s entry mode to the Chinese market. Back in 80’s, foreign companies were not allowed to buy and build factories on the territory of Red Dragon. However, Coca-Cola realized a big potential of Chinese market. After negotiating with some Chinese representatives, Coca-Cola Company built a facility wholly owned by Chinese party. In addition, Coca-Cola was bearing all distribution, promotion and advertising expenses. A few years later, when the government relaxed ownership restrictions, Coca-Cola bought the factory from its partner. Wilfried (2000) introduced another concept – foreign investor sharing corporations, in other words, it is a joint-stock entity. Kodak was the first company that used this particular entry mode in China. Kodak kept the ownership over all fixed assets and granted its partners a small percentage of the stake. Therefore, partners were not involved in daily operations, but were interested in company’s revenues. The main advantage of this entry strategy is an impressive combination of keeping control and reducing risks.

Managerial Implications

There is no straight answer what is the best entry strategy for a particular company. Many factors are involved in making this important decision. Managers should first consider the following questions:

- What industry does a company plan to enter?
- What are the current trends in the overall market and specifically in the chosen industry?
- What business, cultural, governmental and other barriers can be encounter in the course of establishing a company?
  - Who are your potential suppliers?
  - What governmental regulations and restriction apply to your type of business?
  - Who are your competitors?
  - What are their strategies?
  - Who are your customers?
  - What is the best location for your business?
  - Will you be able to get necessary labor resources?

Careful analysis of the above questions would help managers in choosing the right entry mode. In addition, they might foresee some of the coming problems and limitations.

Conclusion

China has become the center of great opportunities for both businesses and people. Globalization and tough competition force companies to expand internationally. Even current economic downturn does not stop foreign investors from expanding to China. Markets in transitional stage always have growing potential. Entering new markets is associated with facing numerous barriers. Chinese market barriers include business, cultural, governmental and other limitations. Findings showed that market barriers influence the choice of the entry mode. In some cases, businesses did not have a choice due to the governmental restrictions to one entity type. In other cases, foreign companies altered traditional entry strategies according to the existing barriers. However, further research recommendations include exploring wholly foreign owned enterprises in more details.
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**APPENDIX**

Figure 1: Which Region Contributes the Most Risk?

![Diagram showing IP infringement, supplier product quality failures, internal product quality failures, lower consumer spend, volatile energy costs, and commodity price volatility for China and United States. Source: AMR Research, 2009.](source)


The purpose of this study is to examine whether the American Institute of Certified Public Accountants (AICPA)’s increased educational requirements for certification, from 120 to 150 credits, improve the quality of the accounting graduate. The researchers examine whether a difference in ethical perceptions exists between newly graduated accounting students from the 120-credit program compared to those graduating from AICPA-mandated 150-credit programs at selected Association to Advance Collegiate Schools of Business (AACSB) accredited colleges in New York State. We measure students’ ethical perceptions using as our foundation Kohlberg’s (1968) Cognitive Moral Development (CMD) theory. A cross-sectional study was conducted using Victor and Cullen’s (1988) Ethical Climate Questionnaire (ECQ), which is based on Kohlberg’s CMD theory. Nine hypotheses derived from the ECQ are tested using independent sample t-tests and Levene’s test for homogeneity of variances. Overall, results for the majority of the hypotheses studied reveal statistically significant differences between the two groups of accounting graduates. The findings of the study suggest that the moral development of accounting graduates from 150-credit programs is consistent with Kohlberg’s theory of moral reasoning.

Introduction

According to Winston Churchill, “there is nothing wrong with change, if it is in the right direction.” Recent changes to the accounting curriculum were established with the expectation that the outcome would be higher quality accountants for the profession. Accounting curriculum revisions instigated by the American Institute of Certified Public Accountants (AICPA) include the 150-credit requirement, which has been adopted by all fifty states (Allen & Woodland, 2006; De Barry, 2003; Taylor & Rudnick, 2005). New York State implemented the 150-credit requirement in August 2008. According to the New York State Education Department (NYSED), the 150-credit rule requires accounting students to complete courses in accounting, ethics and professional responsibility in order to be licensed as a Certified Public Accountant (CPA). Accounting students can still enroll in a 120-credit accounting program; however, completion of this program does not qualify a candidate for licensure as a CPA.
Some have raised concerns regarding the effectiveness of, and the need for, this curriculum change (Bierstaker, Howe, & Seol, 2005). The AICPA’s goal in instituting the 150-credit requirement was to improve the quality of work produced by accountants in a business environment that is continually subject to change (AICPA, 2010). The quality of public accountants’ work is dependent upon the demand for ethical accounting, auditing, and assurance services evidenced by financial reporting (Allen & Woodland, 2006; Carpenter & Stephenson, 2006).

The changes initiated by the AICPA reflect increased interest in the ethical perceptions of newly graduated accounting students (Reckers, 2006). However, it is unclear whether the ethical perceptions of accounting graduates have been affected by business school faculty members who incorporate ethics into their courses and classroom presentations. The purpose of this study, therefore, is to determine the impact on students’ perceptions resulting from the mandated AICPA curriculum change. The framework for the study is provided by Kohlberg’s (1968) theory on moral development and cognitive moral reasoning. Newly graduated accounting students from selected colleges and universities in New York State were surveyed using a questionnaire developed by Victor and Cullen (1988). The questionnaire is based on Kohlberg’s theory. In the study, newly graduated accounting students are defined as those who graduated within the preceding two years.

Research conducted by several business schools has shown that the market for newly graduated accounting students seeking to become CPAs puts greater demands on the profession as a consequence of the unethical acts of some public corporations during the early years of the twenty-first century (Allen & Woodland, 2006; Harrington & Moussalli, 2005). Koestenbaum et al. (2005, p. 13) report that a lack of confidence in accountants’ financial reporting has been a contributing factor in the slowing of U.S. capital markets. A result of these twenty-first century scandals is the passage of the 2002 Sarbanes-Oxley Act (SOX), which addressed unethical behaviors of corporate executives and independent accountants. A goal of SOX was the restoration of public confidence in CPAs (Cunningham, 2006; Koestenbaum, et al., 2005). The Act requires the Securities and Exchange Commission (SEC) to impose stringent rules governing financial reporting, including the issuing of financial statements on publicly traded corporations. SOX also expands penalties for white collar crimes and includes other provisions placing stringent conditions on publicly traded corporations. The first title of the Act established the Public Company Accounting Oversight Board (PCAOB).

The PCAOB’s mission is to protect the public against unethical behavior by public accountants that could result in misrepresentation of financial data pertinent to publicly traded companies (Coates, 2007; Whitley, 2006). The falsification of financial statements audited by public accounting firms such as Arthur Andersen, auditors for Enron, has significantly impacted public, investor, and economic confidence in CPAs (Rau & Weber, 2004). The primary purpose in establishing the PCAOB was to restore public confidence in, and improve the public’s ethical perceptions of, CPAs (Carmichael, 2004).

Although several previous studies have addressed issues relevant to ethical and moral development (Kohlberg, 1968; Rest, 1973; Victor & Cullen, 1988), little research has been conducted regarding the relationship between the incorporation of ethics into the accounting curriculum and the ethical perceptions of newly graduated accounting students. Supporters of the 150-credit requirement agree that the additional credits in the accounting curriculum produce a higher quality student who is better prepared with regard to ethical issues to enter the public sector (Allen & Woodland, 2006).

Moreover, Rezaee (1994) suggests that the 150-credit rule improves students’ ethical perceptions and accounting knowledge, allowing accounting majors to exercise due professional care as future CPAs. Today’s accounting graduates are the future leaders of their accounting firms. Therefore, an inquiry into the ethical perceptions of accounting graduates supports the notion that more education could increase ethical awareness and perhaps avert some future scandals (Myers, 2003).
In an attempt to both improve the ethical perceptions of accounting students and reduce the incidence of ethical violations, the new curriculum was created with increased emphasis on ethics in the classroom (Gaa & Thorne, 2004). To date, little research is available on the extent to which ethical perceptions of newly graduated accounting students have been affected by curriculum changes addressing ethical issues.

**Literature**

While there is a substantial literature on incorporating ethics in the accounting curriculum, there is little research on reported results in terms of testing the effectiveness of ethics instruction in the classroom. The teaching of ethics to accounting students is still a matter for debate. Bampton and Maclagan (2005) are pessimistic, stating that “ethics is not a credible academic subject in a business school context; teaching ethics cannot change the values which people have acquired earlier in life, because learning about ethical theory will not ensure moral conduct” (p. 290). These authors maintain the view that ethics are learned in childhood, long before entering the college classroom. Nevertheless, they propose that “the inclusion of ethics in the accounting curriculum will help practitioners cope with actual ethical dilemmas they may face” (p. 291).

Kunsch, Theys, and Brans (2007), however, argue that the goal of incorporating ethical training in classrooms is to enhance awareness of ethical reasoning in general, which may inform students’ decision making. Clikeman (2003) argues for the importance of educators’ discussions of ethics as a mechanism to stimulate accounting students’ ethical reasoning abilities. He demonstrates that accounting education may influence students’ professional attitudes, suggesting that corporate financial scandals may be curtailed in the future by informing graduating accounting students about ethical dilemmas. Additional findings indicate that “undergraduate accounting education is successful at instilling in students a sense of responsibility for truthful financial reporting” (p. 80). Clikeman is supportive of the 150-credit program only if an ethics course is included in the additional credits.

**Victor and Cullen’s Ethical Climate**

Victor and Cullen fashioned the Ethical Climate Questionnaire (ECQ) for the purpose of examining moral reasoning in relation to the work climate. The ECQ — a two-dimensional model designed to identify a person’s ethical views, actions, proceedings and dealings related to the work environment — has as its first dimension the ethical criterion. The second dimension is the locus of analysis. The ethical criterion is founded on Kohlberg’s (1968) Cognitive Moral Development (CMD) theory.

Victor and Cullen view the “ethical climate as the shared perceptions of what is ethically correct behavior and how ethical issues should be handled” (Victor & Cullen, 1987, p. 52). Referring to the Enron case, Earley and Kelly (2004) conclude that “negative aspects of the ethical climate or culture within Andersen played a pivotal role in its demise” (p. 12). Victor and Cullen demonstrate that those within an organization play an important part in the study of ethical perceptions (Barnett & Schubert, 2002). According to Chan and Leung (2006), further proof of an organization’s ability to sustain an ethical climate results in elevated levels of retention rates, productivity and employee morale. The characteristics of Victor and Cullen’s ECQ regarding individuals’ ethical perceptions address all segments of an organization at a macro level, as opposed to focusing on one area of the organization. However, some have argued that, when it comes to moral decision making, individuals may view an organization’s climate at the micro-level (Gül Selin & Ayse Begüm, 2008). Consequently, Victor and Cullen designed the ECQ based on how individuals perceive the ethical climate types within their organizations (Wyld & Jones, 1997).

Victor and Cullen’s ECQ (Appendix A) is a two-dimensional instrument designed to identify the ethical climate types in an organization. The first dimension is the ethical criterion, which aligns with Kohlberg’s stages of moral development: egoism (self-interest), benevolence (joint interests) and principle or deontology (adhering to a principle), which is an “adherence to universal standards and beliefs” (Gül Selin & Ayse
Begüm, 2008, p. 959). The second dimension suggests that each ethical criterion is related to self or oneself (individual), groups within the organization (local), and the external portion of an organization (cosmopolitan), which links to the locus of analysis shown in Table 1. The development of the locus of analysis was motivated by Merton’s (1957) work on referent groups. Victor and Cullen expound on the locus of analysis in their matrix:

Locus of analysis is a referent group identifying the source of moral reasoning used for applying ethical criteria to organizational decisions and/or the limits on what would be considered in ethical analyses of organizational decisions (Victor & Cullen 1988, p.105-106).

Table 1: Theoretical Ethical Climate Types

<table>
<thead>
<tr>
<th>Ethical Criterion</th>
<th>Individual</th>
<th>Local</th>
<th>Cosmopolitan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egoism</td>
<td>Self-Interest (EI)</td>
<td>Company Profit (EL)</td>
<td>Efficiency (EC)</td>
</tr>
<tr>
<td>Benevolence</td>
<td>Friendship (BI)</td>
<td>Team-Interest (BL)</td>
<td>Social Responsibility (BC)</td>
</tr>
<tr>
<td>Principle</td>
<td>Personal Morality (PI)</td>
<td>Rules (PL)</td>
<td>Laws (PC)</td>
</tr>
</tbody>
</table>


Victor and Cullen identify nine ethical climate types. These climates provide the established practices and procedures for an ethical climate, for which individual ethical perceptions are considered. Based on the earlier work of Victor and Cullen, Martin and Cullen (2006) add a different dimension to the ethical climate, concluding that their meta-analysis of the literature on ethical climate reveals several key variables, including work satisfaction, that are related to ethical climates. Martin and Cullen identify “three bases or criteria of moral judgment: egoism, benevolence, and principle” (as cited in Parboteeah & Kapp, 2008, p. 517), which provide the framework for the three important climates.

Research Questions

In this study, each research question is based on the literature review and has been shown to be an important contribution to the field of ethics (Cullen, Parboteeah, & Victor, 2003; Dellaportas, Leung, Cooper, & Jackling 2006; Earley & Kelly, 2004; Koumbiadis & Okpara, 2008). The research questions (RQs) provide a basis for establishing the hypotheses for this study:

**Main RQ:** Do accounting graduates from the 150-credit program exhibit significantly different perceptions regarding ethics than do graduates from the 120-credit program?

**RQ1:** To what extent was ethical perception of Self-Interest important to the two groups of accounting graduates?
RQ2: To what extent was ethical perception of Company Profit important to the two groups of accounting graduates?

RQ3: To what extent was ethical perception of Efficiency important to the two groups of accounting graduates?

RQ4: To what extent was ethical perception of Friendship important to the two groups of accounting graduates?

RQ5: To what extent was ethical perception of Team Interest important to the two groups of accounting graduates?

RQ6: To what extent was ethical perception of Social Responsibility important to the two groups of accounting graduates?

RQ7: To what extent was ethical perception of Personal Morality important to the two groups of accounting graduates?

RQ8: To what extent was ethical perception of Company Rules important to the two groups of accounting graduates?

RQ9: To what extent was ethical perception of Laws important to the two groups of accounting graduates?

Method

Study participants consisted of 286 accounting graduates listed in the alumni directories of four colleges and universities located in New York State. These participants comprised two groups of accounting graduates: those who had completed 120 credit hours and those who had taken the AICPA’s newly mandated 150-credit program. Participants completed the ECQ, providing data for analysis of the importance of teaching ethics and discussing ethical issues in the classroom.

In the study, we assess whether there are statistically significant differences between accounting graduates in the two groups with regard to their ethical perceptions, as measured by the questionnaire shown in Figure 1. A cross-sectional analysis of the nine ECQ variables was conducted to determine whether statistically significant differences existed among those variables (Salkind, 2003).
Instrumentation

Victor and Cullen’s ECQ, the instrument used in this study, is comprised of 36 questions framed into a two-dimensional model that identifies an individual’s ethical perceptions within an organization. The first dimension is the ethical criterion which aligns with Kohlberg’s stages of moral development: egoism (self-interest), benevolence (joint interests) and principle or deontology (adhering to a principle). The second dimension suggests that each ethical criterion is related to self or oneself (individual), groups within the organization (local), and the external portion of an organization (cosmopolitan). Victor and Cullen describe a locus of analysis as “a referent group identifying the source of moral reasoning used for applying ethical criteria to organizational decisions” (p. 105). The ECQ is used to determine whether differences exist between the ethical perceptions of the two groups. Since additional influences, such as culture, religion and the type of organization where the individual is employed, are not considered in this analysis, the conclusions of the study must be viewed as potentially incomplete.

The validity and reliability of the ECQ have been extensively tested and examined, both in the U.S. and abroad (Dellaportas et al., 2006; Gundersen, Cappozoli, & Rajamma, 2008; Sivadas, Kleiser, Kellaris, & Dahlstrom, 2003). Cullen and Victor (1993) found, “With 1,167 individuals tested across three surveys the results at the individual level have suggested strong support for the validity and reliability of the questionnaire” (p. 667).

Findings

Factor Analysis

The nine factors derived from the ECQ account for 78.88% of the variance of the data. (See Appendix B.) The estimated reliability of the nine factor constructs using Cronbach’s alpha for each factor, as reported in Table 6, are: 0.66, 0.67, 0.65, 0.78, 0.73, 0.66, 0.64 and 0.68, respectively. According to Hair, Bush and
Ortinau (2006), “in most cases, a value of less than 0.6 would typically indicate marginal to low (unsatisfactory) internal consistency” (p. 374). Since each reliability value is greater than 0.60, we conclude that the factors have acceptable reliability.

The factors are related to the theoretical dimensions described by Victor and Cullen’s ethical climate types. The nine identified factors (Self-Interest, Company Profit, Efficiency, Friendship, Team-Interest, Social Responsibility, Personal Morality, Rules, and Laws) reported in Table 6 were validated and shown to be reliable with the theoretical dimensions of the ECQ. The ECQ has been used in previous research and deemed valid (Cullen, Parboteeah, & Victor, 2003; Dellaportas et al., 2006; Trevino et al., 1986).

**Hypothesis Testing**

As reported in Table 2, mean scores for the 150-credit program graduates are greater than mean scores for the 120-credit program graduates for all variables, with the exception of the Social Responsibility variable. These results showing higher mean scores for the 150-credit program graduates support the CMD theory. The rationale explaining these results is the notion that a student progressing through the accounting curriculum from the 120-credit program to the 150-credit program undergoes increased awareness of perceptions regarding ethical issues as a consequence of the increased credits (Clikeman, 2003; Earley & Kelly, 2004; Jones, Massey, & Thorne, 2003). The 120-credit program graduates demonstrated slightly higher mean scores for the Social Responsibility variable.

Detailed results of our statistical analysis for each of the nine research questions are presented below.

**Table 2: Variable Means and Standard Deviations of both accounting programs**

<table>
<thead>
<tr>
<th>Program</th>
<th>120 credit program</th>
<th>150 credit program</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECQ</td>
<td>Mean</td>
<td>Std. Deviation</td>
</tr>
<tr>
<td>EI (Self-Interest)</td>
<td>2.60</td>
<td>.841</td>
</tr>
<tr>
<td>EL (Company Profit)</td>
<td>2.70</td>
<td>.920</td>
</tr>
<tr>
<td>EC (Efficiency)</td>
<td>3.60</td>
<td>.849</td>
</tr>
<tr>
<td>BI (Friendship)</td>
<td>2.90</td>
<td>.769</td>
</tr>
<tr>
<td>BL (Team-Interest)</td>
<td>2.80</td>
<td>.860</td>
</tr>
<tr>
<td>BC (Social Responsibility)</td>
<td>3.39</td>
<td>.850</td>
</tr>
<tr>
<td>PI (Personal Morality)</td>
<td>2.89</td>
<td>.610</td>
</tr>
<tr>
<td>PL (Rules)</td>
<td>3.60</td>
<td>.729</td>
</tr>
<tr>
<td>PC (Laws)</td>
<td>3.69</td>
<td>.720</td>
</tr>
</tbody>
</table>

*Note. 120 credit-hour program N=144, 150 credit-hour program N=142; *p<0.05, **p<0.01*
Hypothesis 1

The first hypothesis tested concerns the ethical perceptions of the two groups of accounting graduates related to the Self-Interest (EI) questions:

\[ H_0^1: \text{There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Self-Interest (EI) factor.} \]

The F-value (6.481), with a p-value of 0.011, indicates a statistically significant difference between the variances of the two groups of accounting graduates with regard to ethical perception of Self-Interest (EI). More importantly, we found no statistically significant difference between the mean scores for the two groups of accounting graduates, using an independent sample t-test. The reported p value (0.224) indicates that we do not reject the null hypothesis that there was no significant difference between ethical perceptions Self-Interest (EI) for the two groups.

Hypothesis 2

The second hypothesis concerns ethical perceptions of Company Profit (EL):

\[ H_0^2: \text{There was no significant difference between the ethical perceptions of the two groups of accounting graduates with regard to the Company Profit factor.} \]

Table 3 reports results for this second hypothesis. The p value for the F-test (0.553) indicates no statistically significant difference between the variances when it comes to the ethical perception of Company Profit (EL). However, a statistically significant difference concerning the Company Profit factor is indicated by the p-value (0.026) for the independent sample t-test. We reject the null hypothesis, indicating that there is a statistically significant difference between the two groups’ ethical perceptions regarding Company Profit.

Hypothesis 3

The third hypothesis addresses differences regarding the ethical perceptions of Efficiency (EC):

\[ H_0^3: \text{There was no significant difference between the ethical perceptions of the two groups of accounting graduates concerning the Efficiency factor.} \]

A statistically significant difference in variances, as related to the ethical perception of Efficiency (EC), is indicated by the F-value (18.037), while the p-value (0.059) for the independent sample t-test shows no statistically significant difference with regard to mean scores for this hypothesis. Therefore, one would not reject the null hypothesis that there was no statistically significant difference in the ethical perceptions regarding Efficiency (EL) between the two groups of accounting graduates.
Hypothesis 4

The fourth hypothesis involves the two groups’ ethical perceptions of Friendship (BI):

$H4$: There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Friendship factor.

The $F$-test (with $F$-value = 41.062) demonstrates a statistically significant difference between the variances of the two groups of accounting graduates on the ethical perception of Friendship (BI) while the independent sample $t$-test reveals a statistically significant difference on the ethical perception of Friendship. Therefore, we reject the null hypothesis that there is no significant difference between the two groups’ ethical perceptions as regards Friendship.
Hypothesis 5

With the fifth hypothesis, we analyze whether a difference exists between the two groups of accounting graduates on the ethical perceptions of Team Interest (BL):

H5: There was no significant difference between the ethical perceptions of the two groups of accounting graduates when it comes to the Team Interest factor.

The $F$-value for this hypothesis (79.546) demonstrates that there is a statistically significant difference between the variances as concerns the ethical perception of Team Interest (BL). The independent sample $t$-test for this hypothesis indicates a statistically significant difference between the two groups of accounting graduates in the 150-credit program and the 120-credit program, so the null hypothesis is rejected and we conclude that there is a statistically significant difference between the two groups’ ethical perceptions concerning Team Interest.

Hypothesis 6

The sixth hypothesis was examined to determine whether a statistically significant difference exists on the ethical perceptions of Social Responsibility (BC):

H6: There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Social Responsibility factor.

A statistically significance exists between the variances of the two groups of accounting graduates when measuring the Social Responsibility (BC) factor; the $F$-value is 14.166. Regarding mean scores for this variable, we find no statistically significant difference demonstrated by the independent sample $t$-test, with $p$-value of 0.214. Therefore, one would not reject the null hypothesis that there was no statistically significant difference between the two groups’ ethical perceptions on the Social Responsibility (BC) factor.
Hypothesis 7

The seventh hypothesis was examined to determine whether a statistically significant difference exists regarding the ethical perceptions of Personal Morality (PI):

\( H7: \) There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Personal Morality factor.

For the Personal Morality (PI) factor, we find a statistically significant difference in both the variances (\( F \)-value = 51.088) and the mean scores, based on the \( p \)-value for the independent sample \( t \)-test (see Table 9). We therefore reject the null hypothesis that there is no significant difference between the groups’ ethical perceptions when it comes to the Personal Morality factor.
Hypothesis 8

The eighth hypothesis addresses differences on the ethical perceptions of Company Rules (PL):

H8: There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Company Rules factor.

A statistically significant difference in variances is indicated by the F-test (with $F$-value 8.513 and $p$-value 0.004) as relates to the Company Rules (PL) factor. Also, a statistically significant difference in mean scores (with $p$-value 0.049) is indicated by the independent sample $t$-test. Therefore, we reject the null hypothesis that there was no significant difference between the groups’ ethical perceptions as regards the Company Rules factor.

Hypothesis 9

The ninth hypothesis was examined to determine whether a statistically significant difference exists between the two groups of accounting graduates on the ethical perceptions of Laws (PC):

H9: There was no significant difference between the ethical perceptions of the two groups of accounting graduates related to the Laws factor.

A difference in variances exists when comparing the two groups as relates to the Laws (PC) factor; the $F$-value (4.477) and $p$-value (0.035) indicate that the difference is statistically significant. More importantly, the independent sample $t$-test ($p$-value = 0.815) used in this study shows that there is no statistically significant difference between the mean scores for the two groups of accounting graduates with regard to the Laws factor. Therefore, the null hypothesis is rejected, indicating that there is no statistically significant difference when it comes to the Laws factor.
Analysis of each of the nine hypotheses was conducted using an independent sample t-test and Levene’s test for the homogeneity of variances. These tests are appropriate for this study because the mean scores were examined to determine whether there were differences between two groups of accounting graduates. Overall, results for more than half of the nine hypotheses tested reveal statistically significant differences between the mean scores for the two groups.

Figure 2 shows the nine hypotheses within the three climate types, egoism, benevolence, and principle of Victor and Cullen’s ECQ model. Hypotheses 2 (Company Profit), 4 (Friendship), 5 (Team Interest), 7 (Personal Morality), and 8 (Rules) show statistically significant differences between the mean scores for the two groups when testing at a 95% confidence level, with the 150-credit program graduates demonstrating greater ethics perceptions. Hypotheses 1 (Self-Interest), 3 (Efficiency), 6 (Social Responsibility) and 9 (Laws) do not display statistically significant differences.
Figure 2

The purpose of this study is to examine whether a difference exists in the ethical perceptions of accounting graduates who participated in the 150-credit program mandated by the AICPA as opposed to earlier graduates who completed 120 credits. As we report, mean scores for the 150-credit program graduates are greater than mean scores for the 120-credit program graduates for all variables except Social Responsibility. The 120-credit program graduates had a slightly higher, but not statistically significantly different, mean score for Social Responsibility.

A possible explanation for this absence of a statistically significant difference is the influence of accounting textbooks used by both groups of graduates on enhancing students’ awareness of notorious scandals surrounding companies such as Arthur Andersen, Enron, Dynegy, WorldCom and Tyco. Another possible explanation may rest in the enactment of the Sarbanes Oxley Act, which both groups of graduates would be cognizant of as a result of taking a mandatory core accounting course, Principles of Auditing. Congress and the SEC now hold accountable public corporations and their accountants for compliance with the regulations mandated by SOX that are designed to restore public confidence in the accounting profession (Cunningham, 2006).

Independent sample t-tests show statistically significant differences for more than half of the nine variables tested. Hypotheses 2 (Company Profit), 4 (Friendship), 5 (Team Interest), 7 (Personal Morality) and 8 (Rules)
showed statistically significant differences at the 95% confidence level, with the 150-credit program graduates showing greater ethical perception. Tests of hypotheses 1 (Self-Interest), 3 (Efficiency), 6 (Social Responsibility) and 9 (Laws) did not reveal statistically significant differences between the two groups.

With regard to each of the ethical criteria *benevolence* and *principle*, two of the climate types show statistically significant differences, with the 150-credit program graduates displaying greater ethical perception. For the ethical criterion *egoism*, only one of the variables displayed a statistically significant difference in the ethical perceptions of the two groups.

It was not unexpected that the ethical climate type *egoism* would show less difference between the two groups of accounting students. This outcome might be a consequence of the fact that both groups have become aware of the current culture’s intolerance for ethical lapses displayed, in recent years, by some major companies and their accountants. Also, recent changes in the accounting curriculum and government intervention have had an impact on those entering the accounting profession.

One of the limitations of this study derives from the fact that the accounting graduates in our sample were all from New York State, which has a significant impact on the global economy by virtue of the fact that Wall Street is in New York City. Perhaps samples of accounting graduates from a different geographic area of the U.S. would exhibit different results. This study indicates a relationship between students’ increased education and heightened ethical awareness for those sampled in the study. It is important to note that this result does not necessarily imply that students with more education are more ethical, but rather that they display increased awareness of ethical issues.

*The Relationship between our Results and the Existing Literature*

The statistically significant results of this study are largely consistent with recent literature indicating that increased education may lead to improved awareness of ethical perceptions (Dellaportas et al.; Earley and Kelly, 2004; Swanson 2005). The literature also suggests that the incidence of ethical lapses may be reduced as a consequence of increased emphasis on educational instruction in ethics (Longenecker, Moore, Petty, Palich, & McKinney, 2006). While there is no consensus among experts on this issue, the majority of the literature indicates that educational intervention in the form of additional accounting courses may, in fact, be effective in promoting ethical development of business school students (Dellaportas et al., 2006; Swanson, 2005). It remains to be seen, however, whether the 30-credit increase in the accounting curriculum has a significant influence on graduating accounting students’ ethical perceptions.

The results of this study demonstrate that the increase of thirty credits initiated by the AICPA has been associated with heightened ethical perceptions of those graduates who have taken the 150-credit program. While there is a limited literature on these changes and on the issue of whether the AICPA’s goal of enhancing the quality of accountants’ work has been met, this study has added to that literature the result that ethical perceptions of the 150-credit graduates in our sample exhibit statistically significant differences that are associated with more education.

*Limitations*

Irrespective of the important findings of this research, the relevant limitations should also be noted. The first of these limitations arises from the need to use a cross-sectional research design rather than a longitudinal design. Because the adjustment of ethical perceptions occurs over time, an optimal design would be longitudinal. However, due to resource limitations, the dimension of time was operationalized as experience and was controlled for statistically.

The second limitation is the fact that the 286 accounting graduates participating in the study were randomly selected from a convenience sample of three nearby institutions. While these students may not be a fair
representation of all New York State accountants who graduated in the last two years, accounting courses are very much comparable across all colleges and universities in New York State.

The third limitation results from the fact that data were collected from self-reporting questionnaires, raising the possibility that responses are affected by a common method. Additionally, it remains to be seen whether the findings of this study can be generalized to all universities or accounting graduates that were not part of the study.

References


Appendix A: Ethical Climate Questionnaire

<table>
<thead>
<tr>
<th>Completely False</th>
<th>Mostly False</th>
<th>Somewhat False</th>
<th>Somewhat True</th>
<th>Mostly True</th>
<th>Completely True</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

1. _____At this organization, employees are mostly out for themselves (EI).
2. _____The major responsibility for employees at this organization is to consider efficiency first (EC).
3. _____At this organization, employees are expected to follow their own personal and moral beliefs (PI).
4. _____Employees are expected to do anything to further the organization’s interests (EL).
5. _____At this organization, employees look out for each other’s good (BI).
6. _____There is no room for one’s own personal morals or ethics in this organization (EI).
7. _____It is very important to follow the organization’s rules and procedures here (PL).
8. _____Work is considered sub-standard only when it hurts the organization’s interests (EL).
9. _____Each employee in this organization decides for himself what is right and Wrong (PI).
10. _____In this organization, employees protect their own interest above other considerations (EI).
11. _____The most important consideration in this organization is each employee’s sense of right and wrong (PI).
12. _____The most important concern is the good of the entire employees in the organization (BL).
13. _____The first consideration is whether a decision violates any law (PC).
14. _____Employees are expected to comply with the law and professional standards over and above other considerations (PC).
15. _____Everyone is expected to stick by organization rules and procedures (PL).
16. _____In this organization, our major concern is always what is best for the other person (BI).
17. _____Employees are concerned with the organization’s interests—to the exclusion of all else (EL).
18. _____Successful employees in this organization go by the book (PL).
19. _____The most efficient way is the right way, in this organization (EC).
20. ______ In this organization, students are expected to strictly follow legal or professional standards (PC).
21. ______ Our major consideration is what is best for everyone in this organization (BL).
22. ______ In this organization, employees are guided by their own personal ethics (PI).
23. ______ Successful employees in the organization strictly obey the organization’s policies (PL).
24. ______ In this organization, the law or ethical code is the major consideration (PC).
25. ______ In this organization, each person is expected, above all, to work efficiently (EC).
26. ______ It is expected that you will always do what is right (BC).
27. ______ Employees in this organization view team spirit as important (BL).
28. ______ Employees in this organization have a strong sense of responsibility to the outside community (BC).
29. ______ Decisions here are primarily viewed in terms of contribution to profit (EL).
30. ______ Employees in this organization are actively concerned about the customer’s and the public’s interest (BC).
31. ______ Employees are very concerned about what is generally best for employees in the organization (BL).
32. ______ What is best for each individual is a primary concern in this organization (BI).
33. ______ Employees in this organization are very concerned about what is best for themselves (EI).
34. ______ The effect of decisions on the customer and the public are a primary concern in this organization (BC).
35. ______ It is expected that each individual is cared for when making decisions here (BI).
36. ______ Efficient solutions to problems are always sought here (EC).

(Copyright, Victor & Cullen, 1998)
### Appendix B: Factor Analysis

<table>
<thead>
<tr>
<th>Factor from ECQ</th>
<th>Factor loading</th>
<th>Factor mean</th>
<th>Cumulative variance explained (%)</th>
<th>Eigenvalue</th>
<th>Cronbach’s Alpha</th>
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<tbody>
<tr>
<td>Factor 1: Moral Caring/Friendship</td>
<td>3.01</td>
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<td>7.59</td>
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<tr>
<td>BI-5</td>
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<td>BI-16</td>
<td>.745</td>
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<tr>
<td>BI-32</td>
<td>.825</td>
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<td>BI-35</td>
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<td>Factor 2: Moral Caring/Team Interest</td>
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<td>Factor 3: Laws and Codes</td>
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<td>Factor from ECQ</td>
<td>Factor loading</td>
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<td>Cumulative variance explained (%)</td>
<td>Eigenvalue</td>
<td>Cronbach’s Alpha</td>
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<td>BC-34</td>
<td>.838</td>
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</table>
Performance of Best CEO Award Winners

Simon S.M. Yang
Associate Professor of Accounting
Adelphi University, USA

Allan S. Ashley
Professor of Management and Decision Sciences
Adelphi University, USA

Jayen B. Patel
Professor of Finance
Adelphi University, USA

ABSTRACT

Investors often seek information regarding promising firm performance or strong executive leadership to assist in making investment decisions. Since 2005, Barron’s Magazine has developed an annual survey that identifies thirty of the most respected or best chief executive officers (CEOs) around the world on the basis of collective interviews among investors, analysts and executives. This paper examines whether a buy-and-hold investment strategy that invests in firms that are winners of the best CEO award (best CEO firms) yield, on average, a higher annual stock return than a matched sample of the marketplace. This study compares average ex post performance of best CEO firms to their industry rivals by using matched industry participants and the top 25% leaders (leaders of firms that exhibit annual return on equity in the top 25% of their industry) who are selected from the same industry segment and the same calendar year as a benchmark. Results indicate that newly awarded best CEOs suffer from high turnovers due to their weak firm performance in the subsequent year. However, best CEO firms exceed, on average, the matched market in stock return, but only before controlling for the risk and the internal return. Firms with best CEOs do not outperform the matched top 25% industry leaders in the current year or in the next two years. The study suggests that the additional stock return over the market earned by the firms with best CEOs may be attributed largely to a risk premium paid to investors who are willing to accept the higher investment risk.

KEYWORDS: CEO performance, CEO awards, CEO overconfidence, Best CEOs.

1. Introduction

Investors frequently seek information regarding a firm’s promising performance in order to improve their investment decisions. Sustainable profit growth, persistent earnings and stock price gains during CEOs tenure, along with other less tangible managerial factors such as leadership strength and industry stature are important indicators of a firm’s future investment potential. During times of economic uncertainty (unpredictability) and volatility in firm performance, investors are likely to rely more heavily on the ability of top executives such as CEOs as an investment yardstick to measure and forecast future firm performance (Hayes and Schaefer (2000)).
Since 2005, *Barron’s Magazine* has compiled an annual list of the thirty “best” CEOs that exhibit the ability to deliver exceptional stock performance and demonstrate an effective and visionary management style. The selection is based on collective interviews among investors, analysts, and executives. The selection criteria require exceptional stock performance and most of the best CEOs have exceeded the Standard & Poor’s 500 market index by a wide margin. Additional characteristics that are associated with the best CEOs include their achievements (e.g., exemplary profit growth), visionary outlook (e.g., pioneer in innovation), and management style (e.g., humanistic and integrity) (Wood and Vikinas (2007)).

It seems natural and reasonable for equity investors to invest in those firms with recognized leadership, courageous vision, impressive management perspective and style, and outstanding profit growth. In *Barron’s* 2009 issue, the best CEOs were acclaimed as “leaders weather the tumult” because they successfully led their company to thrive when economic recessions, financial scandals and plunging stock prices were widespread. The many media recognitions that are accorded to the best CEOs encourage investors to seriously consider the performance of these CEOs and their firms when forming investment portfolios.

This study examines two issues. The first issue involves the hypothesis that a stock investment in a firm led by an award winning best CEO yields, on average, a return higher than the market due to the CEO’s recognized leadership and performance in growing the company. The second issue involves the supposition that the higher than market stock returns for firms with a “best” CEO is volatile and unsustainable. If this situation does exist, it may be caused by a need for a higher return due to the higher risk that results from top CEOs undertaking unrealistic projects and overestimating outcomes. In other words, an investment portfolio that bets on firms led by CEOs that have been given the best CEO award is similar to betting on high growth stocks, i.e., high risk with high returns. Thus, a higher risk premium is necessary to compensate for the higher volatility in the firm’s stock returns.

This paper adds new knowledge and understanding of equity investment by demonstrating that an equity investment that invests in the best CEO firms does outperform the average market return for the current and subsequent two years. However, an important result of our findings is that an investment in a firm led by a top 25% industry leader (i.e., a CEO whose firm earns an annual return on equity in the top 25% of their industry) performs as well as or better than investing in a best CEO firm. Furthermore, this investment is less risky than the investment in the best CEO firms.

### 2. Literature Review

Our review of the literature indicates mixed results in relation to the impact of powerful CEOs on performance of their firms. For example, Agle, Mitchell and Sonnenfeld (1999) examined the impact of several corporate stakeholder attributes on the priority of top management. Agle et al. did not find significant relationship between CEO values and corporate performance. On the other hand, Ashley and Patel (2003) found quality of management had significant positive impact on corporate performance. Ashley and Patel suggest that the board of directors should select a skilled leader since quality of management has a significant impact on corporate performance.

Adams, Almeida and Ferreira (2005) state volatility in stock returns is higher in firms that have powerful CEOs. Adam et al. did not find any clear evidence whether firms with powerful CEOs perform better or worse than comparable firms. In contrast, Malmendier and Tate (2005) indicate overconfident CEOs have tendency to overestimate returns of their investments and prefer internal over external financing. The authors conclude stock options may not be effective in improving the performance of overconfident CEOs. On the other hand, Best (2008), utilizing conference Board survey results, indicates increases (decreases) in CEO confidence and outlook measures are accompanied by increases (decreases) in the returns of the three major stock indices. Best concludes announcements of CEO confidence measures provide valuable information to investors.

Malmendier and Tate (2009) state award-winning CEOs spend more time on outside activities such as writing books and serving on outside boards after receiving awards. They indicate stock returns of award-winning CEO firms are lower than that of matched firms of non-winning award CEO firms. Park, Westphal and Stern (2011) also state overconfident CEOs may make investment decisions that are not necessarily advantageous to the company.
On the other hand, Victoravich, Xu, Buslepp and Grove (2011) indicate powerful CEOs invest in relatively less risky investments. Whereas, Hirshleifer, Low and Teoh (2012) argue overconfident CEOs can exert a positive influence on the firm’s value by investing in riskier projects. The authors find firms with overconfident CEOs achieve more success by investing in innovative industries and exploiting growth opportunities.

We believe there is an on-going debate with respect to the effect award winning CEOs exert on firm performance. The intention of our research study is to contribute to this important discussion.

3. Data and Methodology

Beginning in 2005, Barron’s Magazine initiated its compilation of an annual list of the world’s best CEOs. This list is also published by Dow Jones & Co and the Wall Street Journal. Candidates for Barron’s best CEO award must be on the job for at least three years, and lead companies with market values of at least $5 billion. The selection is based on the collective knowledge of Barron’s staff who have interviewed investors, analysts, and executives to identify those CEOs who have made a difference internally as well as on Wall Street. Profit growth and stock-price gains during the CEOs tenure are an important consideration along with other less tangible factors, such as leadership strength and industry stature. The objective of Barron’s reporting the World’s Best CEOs is to identify chief executives who have built reputations as excellent managers and have delivered outstanding profit growth and gains in earnings for shareholders.

The data consist of a hand-collected list of Barron’s annual best CEOs over the period from 2005 to 2011. This press-based selection method to choose best CEOs from the public media is in line with prior studies (e.g., Hirshleifer et al. (2012) and Malmendier and Tate (2009)). Also note that the data involves the period of economic recession that may have caused the performance of most companies to plummet during the period from 2007 to 2009. The sample consists of those firms in the intersection of Compustat and Barron’s annual thirty best CEO awards from 2005 to 2011, a total of 210 observations. After the deletion of firms without a Cusip number and Compustat data, the total number of observations in the analysis is 182 firm-years representing 74 firms with the best CEO awards.

This study utilizes two matched groups as a performance benchmark in order to evaluate and compare stock returns of firms with the best CEOs to other competitors. The matched market participants were determined by including all the companies with the same first two-digit SIC codes and the same year with those of the best CEO firms. Additionally, a group of the top 25% industry leaders was selected from the population of firms, excluding best CEO firms, based on the criteria that they were ranked in the top 25% of annual returns on equity in each of their industries with matched years and matched two-digit SIC codes. The total number of comparable market participants and top 25% industry leaders with the same two-digit industry code and same calendar year was 20,192 and 2,339 respectively. Following prior studies, this study deleted all control variables lying beyond the 1% significant level at both tails and scaled all non-ratio variables by the lagged stock price in the return-earnings regression to control for multiyear valuation differences (Pfeiffer and Elgers (1999)).

Our study focuses on evaluating a stock investment strategy that involves firms with the best CEOs. It is well documented in prior literature that the return-earnings regression model provides a useful benchmark methodology for firm performance. The regression model specifies the annual buy-and-hold stock return as the dependent variable to evaluate whether investing in best CEO firms exhibits a higher stock return than the average market return after controlling for change in earnings and firm size. The dependent variable for stock returns, \( R_t \), in our analysis is calculated as the change of year-end closing stock prices divided by the price in the previous year. Independent variables include a categorical variable labeled BEST, change of earnings per share, total firm assets, return on equity, debt-to-equity ratio (a measure of firm risk) and beta (another risk sensitive indicator).

The most important independent variable, denoted as BEST, is a categorical variable to separate the effect of experimental groups (i.e., best CEOs) from those of matched control groups (i.e., matched market participants and/or top 25% industry leaders) on stock return. BEST is a dichotomous variable with a value equal to 1 for best CEO firms and 0 for comparable industrial rivals. Previous studies have utilized earnings per share and firm size as the two important relevant variables to explain variation in stock returns (e.g. Ball and Brown (1968) and Ohlson (1995)). Changes in earnings per share, \( \Delta \text{EPS} \), are computed as the
differences of year-end EPS divided by lagged EPS. Size denotes a firm’s total assets divided by its previous year-end closing stock price.

Additionally, this study utilizes profitability and risk measures to examine the mediating effect of these variables on stock returns for firms with the best CEOs. ROE, return on equity, is calculated by dividing income before extraordinary items by total equity. DTE, debt-to-equity ratio, is computed by dividing total liabilities by total equities. Beta, a risk sensitivity indicator is obtained from Compustat and is calculated by measuring a firm’s stock variability for the last 60-month period. If the risk or profitability measures are able to subdue the effect of best CEOs on stock return, the implication is that part of explanatory power of best CEOs is attributable to the risk or profitability factors.

4. Empirical Results

Panel A of Table 1 lists the number of firms that have been on Barron’s best CEO list seven or fewer times from 2005 to 2011. Only four firms, Apple, Berkshire Hathaway, Costco, and Ryanair Holding have been selected for the best CEO award seven consecutive years. Panel B indicates that most CEOs were dropped from the list in subsequent years with an average annual turnover rate of 33.8%. In other words, almost one third of the best CEOs are removed from this prestigious list the year after they were selected as the world’s best CEO. Previous studies indicate high turnover is due to over confident CEOs who often bypass the firm’s corporate governance procedures, undertake risky projects or exercises poor judgment.

Table 1. Frequencies and Turnovers of Annual Best 30 CEOs

Panel A: The Frequencies of Firms on Annual Best 30 CEOs

<table>
<thead>
<tr>
<th>Number of Times on Barron’s Best CEO List</th>
<th>Numbers of Firms (Firm Years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>4 (28)</td>
</tr>
<tr>
<td>6</td>
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<tr>
<td>5</td>
<td>3 (15)</td>
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<tr>
<td>4</td>
<td>10 (40)</td>
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<tr>
<td>3</td>
<td>16 (48)</td>
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<tr>
<td>2</td>
<td>23 (46)</td>
</tr>
<tr>
<td>1</td>
<td>33 (33)</td>
</tr>
<tr>
<td>Total</td>
<td>89 (210)</td>
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Panel B: Annual Turnover Rate for Best CEO Firms

<table>
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<tr>
<th>Year</th>
<th>Turnover Rate</th>
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<tr>
<td>05-06</td>
<td>12/30 = 40.0%</td>
</tr>
<tr>
<td>06-07</td>
<td>9/30 = 30.0%</td>
</tr>
<tr>
<td>07-08</td>
<td>9/30 = 30.0%</td>
</tr>
<tr>
<td>08-09</td>
<td>12/30 = 40.0%</td>
</tr>
<tr>
<td>09-10</td>
<td>11/30 = 36.7%</td>
</tr>
<tr>
<td>10-11</td>
<td>8/30 = 26.7%</td>
</tr>
<tr>
<td>Ave.</td>
<td>61/180 = 33.8%</td>
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Table 1. Frequencies and Turnovers of Annual Best 30 CEOs (continued)

<table>
<thead>
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<th>Reasons</th>
<th>N (%)</th>
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<td>Weak Performance</td>
<td>19 (27.0%)</td>
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<tr>
<td>Retirement</td>
<td>9 (18.4%)</td>
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<tr>
<td>Market Decline</td>
<td>6 (12.2%)</td>
</tr>
<tr>
<td>Expectation Changed</td>
<td>4 (8.2%)</td>
</tr>
<tr>
<td>Reputation Hurt</td>
<td>3 (6.1%)</td>
</tr>
<tr>
<td>CEO Left/Ousted/Lost Job</td>
<td>3 (6.1%)</td>
</tr>
<tr>
<td>Bad Business Decisions</td>
<td>3 (6.1%)</td>
</tr>
<tr>
<td>Economy/Conflict</td>
<td>2 (4.1%)</td>
</tr>
<tr>
<td>Total</td>
<td>49 (100%)</td>
</tr>
</tbody>
</table>

Note: In Panel A, four firms most frequently selected for the best CEO award were Apple, Berkshire Hathaway, Costco, Ryanair Holding.

In Panel C, Barron’s annual best CEOs, starting from 2007, also listed brief reasons for dropping firms from its list. The reasons, not including 2005-2006, classified into “Weak Performance” included weak earnings, profit disappointment, stock plunges, slow growth, significant earnings reduction or stock flagged. “Expectation Changed” included reasons of pricing fears, profit pressure, momentum flagged, or change position. “Reputation Hurt” included reasons such as message-board shenanigans, and the Schering deal.

Barron’s Magazine has given brief reasons that explain why certain best CEOs have been dropped from its list. One of the key selection criteria for best CEOs is based on whether their stock performance exceeds the Standard and Poor’s 500 Index. Weak firm performance is the number one reason for dropping a best CEO firm, representing 27.0% of the dropout reasons. Panel C of Table 1 lists other dropout reasons that include retirement, declining markets, change in expectations, damaged reputation, bad business decisions, etc. The fluctuation in firm performance seems to imply that there is high variability in the ability of best CEOs to continue to successfully lead the firm.

Table 2 provides descriptive statistics on firms with best CEOs awards. Panel A indicates that this study is based on 182 observations for analysis after deleting firms without Cusip numbers or Compustat data. The statistical results in Table 2-Panel B are obtained by applying regression analysis to mean stock returns and changes in earnings per share in each row for firms with different frequencies of being on the best CEO firm list. Panel B described the performance for the best CEO firms. These firms have earned an average 7.2% stock return (median = 3.6% and standard deviation = 36.9%) measured by changes of year-end stock prices. In a study that examines some of the similar concepts as our study, Hirshleifer et al. (2012) reported an average of 17% buy-and-hold (median = 5% and standard deviation = 74%) stock return for press-based confident CEOs (award winning CEOs) over a 1993-2003 period. Although their study is drawn from a different time period and their descriptive statistics are not easy to compare with our study, it is apparent that a high variation in stock returns exists in both studies. An average of 36.9% in stock returns variation also suggests that the variation may be due to significant differences in industry, firm, CEO, and possibly other omitted variables that may affect our results and interpretations.

The results suggest that with respect to stock returns, the CEOs most frequently selected as the best CEOs, on average, outperform new award winners. As an example, the four companies which have been awarded the best CEO seven times earned an average annual return of 17.5%. Changes in EPS were impressive for the most frequent winners of the best CEO award (an average of 20.3% earnings growth for winning the award seven times). However, the rest of the results in Panel B of Table 2 do not support this connection between frequency of best CEO awards and increases in earnings growth.

Panel C of Table 2 demonstrates that best CEO firms vary in size, profitability, and risk. With respect to profitability measures such as ROE, stock price, and earnings, the results indicate that CEOs whose firms have a higher stock price are more likely to be repeatedly selected for the best CEO award. However, it is observed that the average return on equity decreases with an increase in the frequency of awards (t value = -2.00). It appears that the selection of the best CEO firm is influenced more by the market expectation and public recognition and less by shareholders’ equity returns.
Table 2: Descriptive Statistics

Panel A: Firm-years of Best CEOs in Analysis

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<th>Firm Years</th>
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</thead>
<tbody>
<tr>
<td>Firm-years of Best CEOs</td>
<td>210</td>
</tr>
<tr>
<td>No CUSIP Number</td>
<td>(26)</td>
</tr>
<tr>
<td>No Compustat Data</td>
<td>(2)</td>
</tr>
<tr>
<td>Total</td>
<td>182</td>
</tr>
</tbody>
</table>

Panel B: Performance of Firms with Best CEOs

<table>
<thead>
<tr>
<th>Frequency on Barron’s List</th>
<th>Stock Returns (%)</th>
<th>ΔEPS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Median</td>
</tr>
<tr>
<td>7</td>
<td>0.175</td>
<td>0.176</td>
</tr>
<tr>
<td>5</td>
<td>0.094</td>
<td>-0.046</td>
</tr>
<tr>
<td>4</td>
<td>0.028</td>
<td>0.025</td>
</tr>
<tr>
<td>3</td>
<td>0.038</td>
<td>0.012</td>
</tr>
<tr>
<td>2</td>
<td>0.044</td>
<td>-0.008</td>
</tr>
<tr>
<td>1</td>
<td>0.052</td>
<td>0.056</td>
</tr>
<tr>
<td>Average</td>
<td>0.072</td>
<td>0.036</td>
</tr>
<tr>
<td>Coeff.</td>
<td>0.021  (t-value = 2.12)</td>
<td>-0.003 (t-value = -1.09)</td>
</tr>
</tbody>
</table>

Panel C: Firm Characteristics of Best CEOs

<table>
<thead>
<tr>
<th>Frequency Barron’s List</th>
<th>Size</th>
<th>Profitability</th>
<th>Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets (000)</td>
<td>ROE (%)</td>
<td>Price (per share)</td>
</tr>
<tr>
<td>7</td>
<td>92,629</td>
<td>0.149</td>
<td>85.060</td>
</tr>
<tr>
<td>5</td>
<td>47,542</td>
<td>0.095</td>
<td>96.510</td>
</tr>
<tr>
<td>4</td>
<td>416,518</td>
<td>0.274</td>
<td>79.915</td>
</tr>
<tr>
<td>3</td>
<td>268,903</td>
<td>0.212</td>
<td>62.085</td>
</tr>
<tr>
<td>2</td>
<td>109,391</td>
<td>0.235</td>
<td>51.408</td>
</tr>
<tr>
<td>1</td>
<td>41,287</td>
<td>0.261</td>
<td>52.156</td>
</tr>
<tr>
<td>Ave.</td>
<td>162,711</td>
<td>0.204</td>
<td>71.189</td>
</tr>
<tr>
<td>Coeff.</td>
<td>6.251</td>
<td>-0.026</td>
<td>9.075</td>
</tr>
<tr>
<td>(t-value)</td>
<td>(0.16)</td>
<td>(-2.00)</td>
<td>(4.35)</td>
</tr>
</tbody>
</table>

Note: The statistical results on comparisons of different variables against the frequency of times a firm is on Barron’s best CEO list are derived from running a regression on the mean of stock returns (or changes in EPS and other variables) in each row with different frequencies of best CEO firms against a categorical variable from 1 to 6.

The symbol “*” and “**” indicates that the statistical result reaches the significant level of 10% and 5%, respectively.
Table 3 describes the paired comparison of stock returns for best CEO firms with those of matched participants in the market as well as the top 25% industry leaders. The matched market participants in comparison with best CEO firms are determined by including all the companies with the same first two-digit SIC codes and the same year with those of the best CEO firms. The top 25% industry leaders are selected from the population of firms, excluding best CEO firms, based on the criteria that the industry leaders annual returns on equity are ranked in the top 25% of their industry with matched years and two-digit SIC codes.

Panel A of Table 3 demonstrates that best CEO firms, on average, exceeded the market on firm performance measured by stock return and changes in earnings per share. Matched market participants suffered from negative stock returns (-3.9%) and an average earnings plunge of -6.7%. Conversely, the best CEOs led their companies to thrive and grow (with an average stock return = 7.2% and ΔEPS = 17.0%). Compared to their competitors in the matched market, the best CEO firms are significantly larger (t value = 4.28) and exhibit a higher profitability as measured by return on equity (ROE difference = 6.2% with a t value = 7.33). However, it is important to note that the risk measures of debt-to-equity and beta reveal that the best CEO firms are riskier than their industry competitors. These results imply that the high stock returns of the best CEO firms may be attributable to a risk premium paid to investors who are willing to accept more investment risks.

Panel B indicates that the top 25% of industry leaders did just as well as the best CEO firms in earnings growth and stock returns (i.e. there is no significant difference). This result does not support the hypothesis that the best CEO firms outperform the top 25% of industry leaders in firm performance. In contrast, it is interesting to discover that the top 25% industry leaders earned significantly higher ROE (difference = 8.7% with a t value = 6.22) with significantly lower risks (beta difference = 0.056 and debt-to-equity difference = 12.5% at a significance level of 10% and 5%, respectively) than those of firms with the best CEO. Since the stock returns and change in earnings per share of the top 25% industry leaders firms are not significantly different from the best CEO firms, Panel B suggests that an investment strategy betting on best CEOs firms is riskier than betting on the top 25% industry leader firms.

### Table 3: The Comparison of Best CEO Firms with Participants in the Same Industry

#### Panel A: Comparisons with All Firms in Best CEOs’ Industries

<table>
<thead>
<tr>
<th></th>
<th>Best CEOs</th>
<th>Market</th>
<th>Difference (t-test)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Return</td>
<td>0.072</td>
<td>-0.039</td>
<td><strong>0.111 (3.66)</strong></td>
</tr>
<tr>
<td>ΔEPS</td>
<td>0.170</td>
<td>-0.067</td>
<td><strong>0.237 (7.29)</strong></td>
</tr>
<tr>
<td>Size</td>
<td>0.328</td>
<td>0.065</td>
<td><strong>0.263 (4.28)</strong></td>
</tr>
<tr>
<td>Returns on Equity</td>
<td>0.204</td>
<td>0.142</td>
<td><strong>0.062 (7.33)</strong></td>
</tr>
<tr>
<td>Debt-to-Equity</td>
<td>0.610</td>
<td>0.443</td>
<td><strong>0.177 (5.80)</strong></td>
</tr>
<tr>
<td>Beta</td>
<td>0.652</td>
<td>0.518</td>
<td><strong>0.135 (4.31)</strong></td>
</tr>
</tbody>
</table>

#### Panel B: Comparisons with Top 25% Leaders in Best CEOs’ Industries

<table>
<thead>
<tr>
<th></th>
<th>Best CEOs</th>
<th>Top 25%</th>
<th>Difference (t-test)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Return</td>
<td>0.072</td>
<td>0.105</td>
<td><strong>-0.033 (1.45)</strong></td>
</tr>
<tr>
<td>ΔEPS</td>
<td>0.170</td>
<td>0.218</td>
<td><strong>-0.048 (-0.86)</strong></td>
</tr>
<tr>
<td>Size</td>
<td>0.328</td>
<td>0.124</td>
<td><strong>0.204 (4.11)</strong></td>
</tr>
<tr>
<td>Returns on Equity</td>
<td>0.204</td>
<td>0.291</td>
<td><strong>-0.087 (-6.22)</strong></td>
</tr>
<tr>
<td>Debt-to-Equity</td>
<td>0.610</td>
<td>0.485</td>
<td><strong>0.125 (4.10)</strong></td>
</tr>
<tr>
<td>Beta</td>
<td>0.652</td>
<td>0.586</td>
<td>0.056 (1.86) *</td>
</tr>
</tbody>
</table>

**Note:** The matched market participants in the comparison of best CEO firms were determined by including all the companies with the same first two-digit SIC codes and the same year with those of best CEO firms.
Note (continued): The top 25% industry leaders were selected from the population of firms, excluding best CEO firms, based on the criteria that they were ranked in the top 25% of annual returns on equity in each industry with matched years and matched two-digit SIC codes.

The total number of best CEO firm-years is 182 and the comparable market participants with the same two-digit industry code is 20,192 and 2,339, respectively.

The size variable, denominated in millions, was computed as the total assets of firm scaled by lagged stock price.

The symbol ‘*’ and ‘**’ indicates that the statistical result reaches the significant level of 10% and 5%, respectively.

Table 4 reports the comparison of best CEO firms with the market and top 25% industry leaders by using regression analysis and controlling for earnings growth, return of equity, size and two risk measures. A dichotomous variable, BEST, is selected to measure the effect of best CEO firms with a value equal to 1 for best CEO firms and 0 for comparable industrial rivals. The indicator variable, BEST, for the matched market is significantly different from zero ($\beta_1 = 0.062$ with a $t$ value = 1.84 at the significant level of 10%) after controlling for size and earnings growth. This result suggests that investing in best CEO firms, on average, can earn an additional 6.2% return over the matched market with the size and earnings growth taken into consideration. This seemingly profitable investment is subdued after adding risk measures and equity returns. In Model 2, four variables are observed to be significantly associated with current stock return. These variables included earnings per share, size, return on equity and beta. However, the indicator variable BEST is not significantly correlated with current stock returns ($t$ value = 0.44). This result demonstrates that the effect of the best CEO indicator variable on stock return is reduced by the return on equity and beta variables. Additionally, this finding suggests that higher stock returns from firms with best CEOs is related to higher risk.

In a comparison with the top 25% industry leaders, Table 4 reveals that the stock returns are not significantly different between the two groups, Best CEO firms and top 25% industry leaders firms, as indicated by the regression coefficient for the BEST variable i.e., $\beta=-0.041$ ($t$ value = -1.54) after controlling for size and earnings growth (ΔEPS) (Model 1). A similar result is noted after adding the control variables for risk measures and return on equity (Model 2). Overall, Table 4 indicates that the risk premium paid to risk-accepting investors is one possible reason that the best CEO firms exceeded the market. Additionally, stock returns for the top 25% industry leaders perform just as well as the best CEO firms.

Table 4: The Comparison of Best CEOs Firms with Market and the Top 25% Industry Leaders

<table>
<thead>
<tr>
<th>Matched Market</th>
<th>Top 25% Industry Leaders</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model 1</td>
</tr>
<tr>
<td>Intercept ($\alpha_0$)</td>
<td>-0.025 (-7.78)**</td>
</tr>
<tr>
<td>BEST ($\beta_1$)</td>
<td>0.062 (1.84)*</td>
</tr>
<tr>
<td>ΔEPS ($\beta_2$)</td>
<td>0.103 (22.24)**</td>
</tr>
<tr>
<td>Size ($\beta_3$)</td>
<td>0.018 (2.85)**</td>
</tr>
<tr>
<td>ROE ($\beta_4$)</td>
<td>0.202 (1.82)*</td>
</tr>
<tr>
<td>DTE ($\beta_5$)</td>
<td>0.075 (2.32)**</td>
</tr>
<tr>
<td>Adj. $R^2$</td>
<td>2.52%</td>
</tr>
</tbody>
</table>

Notes on following page.
Notes for Table 4: The total number of best CEO firm-years is 182 and that of the comparable market participants and top 25% industry leaders with the same two-digit industry code is 20,192 and 2,339, respectively.

BEST is a dichotomous variable with a value equal to 1 for best CEO firms and 0 for comparable industrial rivalries. Stock return, $R_t$, was calculated as the change of year-end closing stock prices scaled by the price at the previous year. Change of earnings per share, $\Delta EPS$, was computed as the differences of year-end EPS scaled by lagged EPS. Size denotes a firm’s total assets scaled by its previous year-end closing stock price. ROE, return on equity, was calculated from dividing income before extraordinary items by total equity at end of year. DTE, debt-to-equity ratio, was computed from dividing total liabilities by total equity. Beta, a risk sensitivity indicator calculated from measuring a firm’s stock variability for last 60-month period, was obtained from Compustat.

The symbol “*” and “**” indicates that the statistical result reaches the significant level of 10% and 5%, respectively.

The results in Table 5 - Panel A for the regression coefficient BEST indicate that one year after a firm is selected as the best CEO firm, its stock return exceeds the matched market firm’s stock return by 2.8% ($t$ value = 1.81 at a significant level of 10%). In year two, the regression coefficient BEST indicates that the stock returns of the best CEO firm exceeds the matched market firm’s stock returns by 4.5% ($t$ value = 2.26 at a significant level of 5%). However, the results also indicate that a change in earnings per share, $\Delta EPS$, is not significant in explaining a year-ahead stock return.

The regression results indicate a significant negative association for two-year-ahead stock returns and a change in earnings per share ($\Delta EPS$) (-0.019 and a $t$ value = -2.94). This unusual result is due to the well documented mean reversion in the accounting earnings process (Ou and Penman (1989) and Sloan (1996)). A summary of our results in Panel A suggests that the additional return of best CEO firms over the matched market is subdued after controlling for return on equity and the two risk measures. Risk factors such as beta (regression coefficient = 0.087 and a $t$ value = 2.10 at the significant level of 10%) appear to affect the best CEOs future stock performance.

Table 5: Future Performance for Firms with Best CEOs

Table 5 indicates that the best CEO firms do not outperform the top 25% of industry leaders in stock returns for the subsequent two years after the selection of the best CEOs firms. The risk factors, beta (coefficient = 0.207 and a $t$ value = 1.99) and debt-to-equity ratio (coefficient = 0.234 and a $t$ value = 1.79) are still significant, indicating that investors weigh risk premium as an important consideration at least in year
one for future stock performance. In summary, Panel B reveals that there is no significant difference between best CEO firms and the matched top 25% industry leaders in future stock return. Additionally, the results of this table reveal that future stock returns are related to measures of firm risk (beta and debt to equity).

### Table 5-Panel B: Comparison with Top 25% Industry Leaders

<table>
<thead>
<tr>
<th></th>
<th>Year +1</th>
<th>Year +2</th>
<th>Year +2</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept ($\alpha$)</td>
<td>-0.004 (-0.43)</td>
<td>-0.268 (-2.03)</td>
<td>-0.055 (-4.77)</td>
<td>0.131 (0.86)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BEST ($\beta_1$)</td>
<td>0.008 (0.26)</td>
<td>-0.199 (-1.53)</td>
<td>0.047 (1.17)</td>
<td>0.142 (1.08)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ΔEPS ($\beta_2$)</td>
<td>0.027 (1.87)*</td>
<td>0.019 (0.32)</td>
<td>-0.003 (-0.13)</td>
<td>0.183 (2.75)**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size ($\beta_3$)</td>
<td>-0.007 (-0.59)</td>
<td>0.308 (0.36)</td>
<td>-0.004 (-0.32)</td>
<td>-1.031 (-1.28)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE ($\beta_4$)</td>
<td>0.079 (0.31)</td>
<td>0.234 (1.79)*</td>
<td></td>
<td>0.161 (1.14)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DTE ($\beta_5$)</td>
<td></td>
<td>0.207 (1.99)**</td>
<td></td>
<td>0.078 (0.73)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beta ($\beta_6$)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** All variable definitions are the same as in the previous tables. The total number of best CEO firms evaluated for future firm performance declined to 170 because twelve CEOs who were either going to retired or leave were omitted from the analysis.

### 5. Conclusions and Discussions

Previous studies of executives who win awards for best CEO propose that increases in CEO power in large corporations are often detrimental to shareholders. CEOs newly selected for awards are more likely to use their new public recognition and influential power to extract private benefits (e.g., media appearances, high compensation, book writing), engage in riskier projects, provide overoptimistic forecasts, or invest in uncertain innovations without following appropriate corporate governance procedures (Malmendier and Tate (2009); Hribar and Yang (2011)). An increase in status and recognition often distorts CEO behavior and decreases subsequent firm performance. Adams et al. (2005) found that stock returns are more volatile for firms run by powerful CEOs. Firm performance declines, not rises, following wide public recognition and media appearances of CEOs (Malmendier and Tate (2009)).

The results in this study suggest that investing in the best CEO firms does yield a higher stock return than the average market return. However, once risk measure, equity return, and firm size are controlled for, this additional yield decreases in value. In addition, this study finds no evidence to support the supposition that investing in best CEO firms is more profitable than investing in companies whose CEOs have led their companies in achieving performance measures ranked in the top 25% of their industry. In fact, annual buy-and-hold stock returns for the top 25% industry leaders are approximately the same as the returns for best CEO firms. The study also indicates that the firms that are characterized as the top 25% industry firms are less risky as measured by debt-to-equity and beta risk measures. Furthermore, these firms are more profitable as measured by return on equity.

In summary, the results indicate that while the list of best CEOs is a useful investment reference and tool, an investment betting on best CEOs is riskier than an investment in either a matched market firm or a firm that performs in the top 25% of its industry. From the perspective of investment decisions, this study suggests that the higher stock returns of best CEO firms over the market are attributed to higher risk. Furthermore, an investment strategy committed solely to those firms with best CEOs appears to bear a higher risk than the risk incurred from an investment in the top 25% industry leaders due to the higher variability in best CEOs subsequent firm performance.

**Acknowledgements:** The authors thank two anonymous reviewers for helpful comments and suggestions.
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