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Ethics of Corporate Governance

Abstract

A lot has been said and written about the corporate greed but what actually goes on into making a sound corporate decision has barely been discussed. The tussle of choosing between the interest of the shareholders as well as other investors over the corporate social industry has hounded the corporate board rooms for a substantial period of time. While making these decisions the board as well as the directors are subjected to a lot of pressure as well a moral dilemma. While making these decisions a number of competing as well as supplementing theories could be applied in order to make the "right decision". This paper would attempt to understand the implication of these competing theories in making the right decision in order to understand how this conundrum could be diluted and a forward approach could be devised.

Keywords: Acquisition, Corporate Governance, Business Ethics, Transparency, Teleological, Deontological, Governance Mechanism, Fairness.

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Introduction

Let us delve straight into it and take the place of individual members on a board of directors of a company who need to take action. They are faced with a decision, as are most of us in any other aspect of life- what is the right thing to do? In most cases, choosing the right course of action is not something that infringes on morality or even involves moral issues and is simply a commercial call to take. In another few cases, the choice is again fairly simple as the same call for compliance of a specific statute or a regulation which might be in place. However, there are numerous other decisions- especially in cases of major decisions such as mergers, down-sizing or company investments- where neither business judgment or regulations are clear. Such decisions may involve a conflict with respect to what is right in a moral sense and what may be commercially or even individually beneficial. Therefore, it has been observed that most important decision making in a boardroom is a matter of ethics. [1]

The same issue came up while the author was interning at a law firm and there was an acquisition of the firm's client by a larger company. The boardroom was prima facie agreeable to the same, even though it was clear that such acquisition would almost certainly result in a huge loss of the present working force- people who had been with the company since its inception- and would make the company divert from its original goal and make it to be just a supplement of a larger brand. The board seemed to be going ahead with the deal irrespective, presumably because of the huge sums being mentioned- the same made working and 'helping' out in the deal a proper ethical dilemma for the author. Reading up further on the issue revealed to me that most important decision-making in a boardroom does go on to involve a matter of ethics.[2]

This article will explore and analyse whether the author's dilemma holds water. It will go onto explore whether the dilemma was just limited to the specific deal or evidence of a systematic malaise which gives rise to such ethical problems time and again. It will juxtapose and evaluate theories of corporate governance, though it will try to avoid straitjacketing the discussion into mere theories. It will begin with a general discussion about business ethics and corporate governance and move onto whether changes are possible or even required and whether the same would help in solving the current dilemma.

Aim of the Stiudy

Through this paper, the author would examine the ethical concerns as well as the practical concerns which are kept in mind of while introducing issues like corporate social responsibility in corporate entities and the other issues associated with corporate governance. Also subsequent knowledge creation would also be the aim.

Review of Literature

K.R. Sampath, Law of Corporate Governance: Principles and perspective (2006)

In this book the author has attempted to underline the principles which govern the corporate governance. This also highlighted various perspectives to this issue. From the point of view of providing an understanding of the legal framework relating to the corporate governance, the book goes a long way.

P.V. Sharma and S. Rajani, Corporate Governance: Contemporary Issues and Challenges (2007)

This book serves an important function of discussing the contemporary issues as well as the challenges that come along the way of corporate governance. Along with that, it also helps in understanding the practical limitations of the system of corporate governance.

Crowther, D. and K.T. Caliyurt, Stakeholders and Social Responsibility. Kuala Lumpur, Ansted University Press. (2004)

Through this book the author very effectively tries to establish an understanding towards the issues which the stakeholders face during the processing of introducing social responsibility in the corporate system.

Evan, W.M. and R.E. Freeman, A Stakeholder Theory of the Modem Corporation: Kantian Capitalism. Ethical Theory and Business.(1998)

This book could be seen as an effort to provide a comparative understanding to the various theories of the modern day corporation along with giving an understanding about the causes that were responsible for the shift in this theoretical basis of the corporations.

Corporate Governance and Business Ethics

It is very obvious and clear that any national code pertaining to corporate governance emphasizes on the ethical perspective of good corporate governance. There is always a special emphasis on the fact that good corporate governance is based in cardinal ethics. Values such as transparency, responsibility and accountability usually account for most of the rhetoric about corporate governance. It is argued that the same should ideally be the bedrock of all aspects of governance and it is hardly something required to be imposed by norms or regulations. There are other business standards which involve the company being at a high ethical standard- most such practices having commercial sense as the same is used to attract investors and improve the brands associated with the same. Furthermore, it is seen that such practices are often however cosmetic in nature as the concern is more about the image being portrayed rather than for actual concern for the same.[3]

In recent years, there have been a lot of high profile scandals which have involved abuse of corporate governance norms- the same bringing Corporate Governance into much sharper focus. For the process of increasing the accountability of the corporate entities, efforts have always been made to extend the civil as well as criminal liabilities of individuals so that they are better accountable for their actions. In order do it, there has been efforts to incorporate or rather extend these provisions in the national legislations as well.[4] Bu when it comes to the actual application of these codes there has been a certain amount of discrepancy. There has been a stress on the codes dealing with this issue both at the level of the liability as well as the code off the ethics with which the board are entrusted with. The board as well plays an important role in ensuring that the requisiteliabilities are entrusted upon the actual culprits. But despite this effort most of the codeslack the procedural requisites. These has been a lapse on part of the board to actually establish a specific procedure that need to be followed in order to ensure that the actual a workable code dealing with the ethics is developed.[5]

Corporate Governance Norms- Change Possible?

It is to be noted that corporate governance structures usually come in to concern or light as a response to major incidents which result in a crisis of confidence, market failure or even fraud. The first major incident was the 1929 stock market crash which gave a wake up call to the community in recognizing how different the moral and economic priorities and imperatives were of investors and the corporates. Yet another major re-evaluation was in the 1990s when there were a string of incidents, far less dramatic, but enough that they reverberated in the new for years after. They were the collapse of the Bank of Commerce, Credit International and Polly Peck. The same threw into doubt the principle based and the self regulatory system of accounting that had come into place as financial regulations and also in most boardrooms.[6] The USA, usually a front runner in most corporate governance norms and regulations, also saw the enactment of the Sarbanes-Oxley Act in 2002 after the excesses of the dot-com era in the late 1990s and the consequent collapse of Enron in 2001 and WorldCom as well. This paved the way for strict regulation and almost a statutory stranglehold, primarily keeping in mind investor protection and interests.[7]

Therefore, it was clear that there was a sense of moral hazard when there was an accumulation of wealth and/or power in the hands of corporations or the wealthy organisations. There was a sense of untrustworthiness and unaccountability as far as directors were concerned and there was an apprehension that they would be open to corruption. While there were obvious questions on the personal morality of individuals, such incidents also raised questions on the system as well which allowed such systems to exist. Such questions or doubts also raise questions about the four major corporate governance theories- agency theory, shareholder value, stakeholder theory and stewardship theory.

It is stated that six theories of corporate governance can be outlined, though practically only three can be said to have normative character. Firstly, the legal view is a myopic one as it reflects only the role-fulfilling obligations of company law but does not detail in any manner guidance for morality of their

actions. It is to be noted that while directors have *de jure* responsibility, the *de facto* control of the same lies with the management.[8] Other theories such as *class hegemony* or *managerial hegemony* are purely descriptive in what they prescribe and too often boards just perpetuate the interests of a 'ruling elite' in pursuance of such theories which focus squarely on the commercial side of things. It is argued that a *stewardship theory* is one of the better postulations regarding corporate governance as it assumes a psychological stance- managers, and consequently directors, are thought and expected to be guided by things other and 'greater' than narrow self interest. It is argued that such an approach to formulating corporate governance norms and regulations will result in better and more conducive practices amongst the management itself. It is further argued that such practices can only be ingrained as being the norm if there are systematic changes which come up organically in corporate governance regulations.[9]

An Ethical Framework for Governance

The two approaches known as consequential (sometimes called teleological) and idealistic (also called deontological) are encompassed in these theories of corporate governance in the field of ethics. An assessment of the benefits arising from it (outcome of the action is the determinant of the morality) or by adhering to some more general rule or ideal state (some ethical principle) irrespective of the outcomes of the action is the determinant of the right course of action. The former is probably best known in its 18th and 19th Century incarnation – utilitarianism, grasping John Stuart Mill's notion of the greatest good for the maximum number, which contributed greatly in the field of economics. However, a role in corporate governance, ethical egoism is played by consequential thinking, in which one decides what suits best for oneself, irrespective of the consequences for others. Epicurus, Hobbes and Nietzche were its proponents. The three philosophers, however, do not enjoy the great fans club which they did once except perhaps among CEOs.[10]

The notion that when other actors invoke governance mechanism like a contract and the force the law to limit the actions of the egoists is based on the assumptions we see at work in agency theory. Any self-interested actor, including the CEO, will seek to maximize personal gains. Without dampening the CEO's drive to succeed, his actions are limited by the role of corporate governance. In agency theory, the board negotiates with the CEO and pay policies to channelize energy towards common outcomes for the rest of senior management, though with different specific goals: assumption is that the CEO will try to maximize his personal gains. If the path to do that also maximizes shareholders' wealth, then job is well done. It is argued that nearly all the traditional corporate governance literature is underpinned the mentioned ethical stance. Business culture leads to people seeking maximizing profits, personal or corporate.[11] If the means to that end vary, which depends on what kind of perception generated while looking at the personal or corporate, greed is widely thought to take precedence over the sense of corporate purpose. The approach is not confined to the boardroom. Much of management literature and the "how-to" approach to organizational change convey the idea of alignment of personal goals along with incentives with corporate aims.

Conclusion

It has been very aptly put that ethics is always the first and should ideally be the last line of defence as well against corruption whereas any law enforcement is more of a remedial and reactive nature. It is obvious that good corporate governance always goes far beyond mere regulations, as evidenced above by the stewardship theory. The values which drive the company play a major role in how the company conducts its business. We see a company like Infosys always having a great track record with respect to corporate governance majorly because of the kind of leadership and culture which is instilled in it. It is obvious that just the existence of good practices will not ensure ethics, or even the the presence of ethics will ensure smooth running of the business. The fact that people on most board of directors still have an inclination to act in ways which are averse to public investor interest also shows the separation of interests- a good corporate governance regime would at least attempt to reconcile these interests to ensure fairness of actions. The author feels that it is only when there is change in norms and principles guiding the companies presently that the actions usually seen to be taken nowadays by boards would be guided towards being more favourable towards investors, employees, etc. Such change, as argued above, is only possible with identifying what principles are fit in the current commercial climate and incorporating them organically.

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Endnotes

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