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Corporate Governance and Business Ethics

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Abstract

Corporate Governance is highly related with ethical conduct of business. There is a strong need for corporate managements to adopt transparent process and good governance practices. Corporate governance is a system of making directors accountable to the stakeholders for effective management of the companies, in the best interest of the company along with concern for ethics and values. It hinges on complete transparency, integrity and accountability of management that includes executive and non-executive directors. Corporate Governance is an important concept to achieve corporate excellence. Managements should pursue the path of dynamic success to achieve corporate excellence. Ethics are important for dynamic success. Ethics of success is entwined in corporate governance. If ethics of success is ignored, failure inevitably results. And failure increases costs considerably and erodes profitability. As success depends on corporate governance, managements must believe in and practice good governance principles. To experience the goodness of corporate governance and to realize its immense benefits, corporate should have strong belief in the concept and its practice. A meaningful policy on Corporate Governance must provide empowerment to the executive management of the Company, and simultaneously create a mechanism of checks and balances which ensures that the decision making powers vested in the executive management is not only not misused, but is used with care and responsibility to meet stakeholders' aspirations and societal expectations. The practice of Corporate Governance leads to the creation of the right corporate culture. Business ethics (also known as corporate ethics) is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and business organizations as a whole. Applied ethics is a field of ethics that deals with ethical questions in many fields such as medical, technical, legal and business ethics. Ethics in Corporate governance means the parameters which a company sets for itself for its functioning. Transparency and disclosures about accounts as well as other important issues have to be communicated to the stakeholders in a truthful and prompt manner. These build up confidence and trust in the marketplace. When issues like Enron, WorldCom, UTI, Ketan Parekh, Harshad Mehta, Satyam etc.hit the headlines, it is difficult to ignore business ethics. As consumers are getting increasingly aware of ethical issues, corporations have to respond to their concerns whether it is related to issues of environment, heath or any other concern. In this paper, we will look into the concept of Corporate Governance, its framework, structure and philosophy. We will also take a look at the need for ethics in business, its benefits and suggestions.

Keywords: *Corporate Governance, Business Ethics, Narayan Murthy, SEBI, NIHS, ICAI etc.*

Introduction

Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.

Ethics in Corporate governance means the parameters which a company sets for itself for its functioning. Transparency and disclosures about accounts as well as other important issues have to be communicated to the stakeholders in a truthful and prompt manner. These build up confidence and trust in the marketplace. When issues like Enron, WorldCom, UTI, Ketan Parekh, Harshad Mehta, Satyam etc hit the headlines, it is difficult to ignore business ethics. As consumers are getting increasingly aware of ethical issues, corporations have to respond to their concerns whether it is related to issues of environment, heath or any other concern.

What is Corporate Governance ?

Since the beginning of the liberalization process, economic scenario has begun to change radically. Globalization has not only increased and intensified business risks, but has also compelled Indian companies to adopt international norms of transparency and good governance. In the same way, in the resultant competitive context, freedom of executive management and its ability to respond to the dynamics of a fast changing business environment will be the new success factors. Corporate Governance policy recognizes the challenge of this new business reality. The ambit of significance of Corporate Governance lies far beyond this.

Some experts like Narayana Murthy, J J Irani and Naushir Mirza adopt a broader definition of CG to include the interests of all the stakeholders like shareholders, employees, customers, creditors and the society at large. Maintaining the balance between different and often conflicting interest groups is however an extremely difficult task, which is in fact, the real challenge of good governance.

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed.

Corporate governance is a multi-faceted subject. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem.

SEBI defines "Corporate Governance as the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." The definition is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution. Corporate Governance is viewed as business ethics and a moral duty.

A Conceptual Framework

Corporate Governance is a system of structural, procedural and cultural safeguard designed to ensure that a corporation is run in the best long term interest of its shareholders as well as other stakeholders. Corporate Governance is -

- Philosophy of Business
- Business Ethics
- Culture of organization
- Corporate Social responsibility
- Shareholder Value creation
- Dynamic Leadership
- Clean and Green world

Corporate governance is not merely about "ethical conduct of business" as defined by SEBI. It is also about leadership, especially top leadership at the level of CEO and CFO and Board of Directors.

The Governance Structure

Corporate Governance must take place at three interlinked levels, namely –

- Strategic supervision by the Board of Directors
- Strategic management by the Corporate Management Committee
- Executive management by the Divisional Chief Executive assisted by the Divisional Management Committee

Appropriate balance between freedom of management and accountability to shareholders can be achieved by segregating strategic supervision from strategic and executive management. The Board of Directors (Board) as trustees of the shareholders will exercise strategic supervision through strategic direction and control, and seek accountability for effective strategic management from the Corporate Management Committee (CMC). The CMC will have the freedom, within Board approved direction and framework, to focus its attention and energies on the strategic management of the Company. The Divisional Chief Executive, assisted by the Divisional Management Committee, will have the freedom to focus on the executive management of the divisional business.

The 3-tier governance structure thus ensures that:

1 Strategic supervision (on behalf of the shareholders), being free from involvement in the task of strategic management of the Company, can be conducted by the Board with objectivity, hereby sharpening accountability of management.

2 Strategic management of the Company, uncluttered by the day-to-day tasks of executive management, remains focused and energised; and

3 Executive management of the divisional business, free from collective strategic responsibilities as a whole, gets focused on enhancing the quality, efficiency and effectiveness of its business.

The Governance Philosophy

From the above definition and core principles of Corporate Governance, there emerges the cornerstone of governance philosophy, namely trusteeship, transparency, empowerment and accountability, control and ethical corporate citizenship. The practice of each of these leads to the creation of the right corporate culture in which the company is managed, that fulfils the purpose of Corporate Governance.

- **Trusteeship**

  Social and economic purpose is the vital concern of any large corporations. They represent a coalition of interests, namely those of the shareholders, other providers of capital, business associates and employees. This belief therefore casts a responsibility of trusteeship on the Company's Board of Directors. They are to act as trustees to protect and enhance shareholders value, as well as to ensure that the Company fulfils its obligations and responsibilities to its other stakeholders. Inherent in the concept of trusteeship is the responsibility to ensure equity, namely, that the rights of all shareholders, large or small are protected.

- **Transparency**

  Transparency means explaining Company's policies and actions to those to whom it has responsibilities. Therefore, transparency must lead to maximum appropriate disclosures without jeopardising the Company's strategic interests. Internally, transparency means openness in Company's relationship with its employees, as well as, the conduct of its business in a manner that will bear scrutiny. Transparency enhances accountability.

- **Empowerment and Accountability**

  Empowerment is an essential concomitant of first core principle of governance that management must have the freedom to drive the enterprise forward. Empowerment is a process of actualizing the potential of its employees. Empowerment unleashes creativity and innovation throughout the organisation by truly vesting decision-making powers at the most appropriate levels in the organizational hierarchy.

  The Board of Directors are accountable to the shareholders, and the management is accountable to the Board of Directors. Empowerment, combined with accountability, provides an impetus to performance and improves effectiveness, thereby enhancing shareholders value.

- **Control**

  Control is a necessary concomitant of its second core principle of governance that the freedom of management should be exercised within a framework of appropriate checks and balances. Control should prevent misuse of power, facilitate timely management response to change, and ensure that business risks are pre-emptively and effectively managed.

- **Ethical Corporate Citizenship**

  Corporations have a responsibility to set exemplary standards of ethical behaviour, both internally i.e., within the organization, as well as in their external relationships. Unethical behaviour corrupts organizational culture and undermines stakeholder's value.

- **Legal Compliance**

  The Company must comply fully with all applicable laws and regulations. Ensuring legal and regulatory compliance is the responsibility of the Chief Executives of the Businesses and the Divisional Management Committees (DMC). The Company cannot accept practices which are unlawful or may be damaging to its reputation. The DMC must satisfy themselves that sound and adequate arrangements exist to ensure that they comply with the legal and regulatory requirements impacting each business and identify and respond to developments in the regulatory environment in which they operate. In the event the implication of any law is not clear, the Company's Legal Department shall be consulted for advice.

- **Health and Safety**

  Healthy and safe work environment must be given due importance by the company. It must be committed to provide good physical working conditions and encourages high standards of hygiene and housekeeping. Particular attention should be paid to training of employees to increase safety awareness and adoption of safe working methods, particularly designed to prevent serious or fatal accidents.

- **Environmental Policies**

  Commitment to sustainable development is a key component of responsible corporate citizenship and therefore deserves to be accorded the highest priority. Accordingly, the Company is committed to Best Practices in environmental matters arising out of its business activities and expects each business to fully demonstrate this commitment.

  Besides complying with applicable laws and regulations, businesses must establish procedures for assessing the environmental effects of their present and future activities. They should adopt best practices in their environmental policies and procedures.

- **Personal Conduct**

  All directors, senior management and employees have the obligation to conduct themselves in an honest and ethical manner and act in the best interest of the Company at all times. They are expected to demonstrate exemplary personal conduct through adherence to the following:

- **Avoidance of Conflict of Interest**

  Conflict of Interest is not at all expected for smooth governance. All directors, senior management and employees must avoid situations in which their personal interest could conflict with the interest of the Company. This is an area in which it is impossible to provide comprehensive guidance but the guiding principle is that conflict, if any, or potential conflict must be disclosed to higher management for guidance and action as appropriate.

- **Transparency and Audit-ability**

  All directors, senior management and employees shall ensure that their actions in the conduct of business are totally transparent except where the needs of business security dictate otherwise. Such transparency shall be brought about through appropriate policies, systems and processes, including as appropriate, segregation of duties, tiered approval mechanism and involvement of more than one manager in key decisions and maintaining supporting records. It shall be necessary to voluntarily ensure that areas of operation are open to audit and the conduct of activities is totally auditable.

- **Protection of Confidential Information**

  No director, senior management and employee shall disclose or use any confidential information gained in the course of employment/ association with the Company for personal gain or for the advantage of any other person. No information either formally or informally shall be provided to the press, other publicity media or any other external agency except within approved policies.

- **Company Facilities**

  Company facilities shouldn't be misused by any director, senior management and employee. In the use of Company facilities, care shall be exercised to ensure that costs are reasonable and there is no wastage.

- **Leading by Example**

  The directors and senior management of the organisation set the professional tone for the Company. Through both their words and their actions, the organisation's leadership conveys what is acceptable and unacceptable behaviour. The company's directors, senior management and employees must constantly reinforce through their actions and behaviour that the company stated beliefs of responsible corporate citizenship are rooted in individual conviction and personal integrity

  Any instance of non-adherence to the Code of Conduct / any other observed unethical behaviour on the part of those covered under this Code should be brought to the attention of the immediate reporting authority, who shall in turn report the same to the Head of Corporate Human Resources.

- **Dealing with People in the Organization**

  In dealing with each other, directors, senior management and employees shall uphold the values which are at the core of HR Philosophy - trust, teamwork, mutuality and collaboration, meritocracy, objectivity, self respect and human dignity. Indeed, these values form the basis of HR management systems and processes. In selection and recruitment, while meritocracy will be a prime criterion, managers will scrupulously consider all factors that go towards securing the interests of the Company. It must focus on meritocracy, equity and upholding of Company values in all people processes including performance management systems, appraisals, remuneration and rewards.

- **A Gender Friendly Workplace**

  As a good corporate citizen, it must be committed to a gender friendly workplace. It should seek to enhance equal opportunities for men and women, prevent/stop/redress sexual harassment at the workplace and institute good employment practices.

  The company should maintain an open door for reportees; encourages employees to report any harassment concerns and is responsive to employee complaints about harassment or other unwelcome and offensive conduct. A committee has to be constituted to enquire into complaints and to recommend appropriate action, wherever required.

  The company must demand, demonstrate and promote professional behaviour and respectful treatment of all employees.

- **Relationships with Suppliers and Customers**

  All directors, senior management and employees shall ensure that in their dealings with suppliers and customers, the Company's interests are never compromised. Accepting gifts and presents of more than a nominal value, gratuity payments and other payments from suppliers or customers will be viewed as serious breach of discipline as this could lead to compromising the Company's interests.

Business Ethics

Importance of ethics in the business world is superlative and global. New trends and issues arise on a daily basis which may create an important burden to organizations and end consumers. Nowadays, the need for proper ethical behavior within organizations has become crucial to avoid possible lawsuits. The public scandals of corporate malfeasance and misleading practices, have affected the public perception of many organizations (e. g., Enron, Arthur Andersen, WorldCom, UTI, Ketan Parekh, C R Bhansali, Harshad Mehta, Satyam etc.).

Business ethics (also known as corporate ethics) is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and business organizations as a whole. Applied ethics is a field of ethics that deals with ethical questions in many fields such as medical, technical, legal and business ethics.

The recent expansion of global business and fall of trade barriers worldwide have further underlined the interest in the topics of ethical behavior and social responsibility. In addition, as many scholars believe, human rights and environmental conservation are gaining increasing more recognition in both academic and commercial settings. As multinational companies expand globally and enter foreign markets, ethical conduct of the officers and employees assume added importance since the very cultural diversity associated with such expansion may undermine the much shared cultural and ethical values observable in the more homogeneous organizations.

Businesses annually spend an estimated $40 billion on the ethical behavior problems. Thus, pointing to the fact that ethical dimension of employees' behavior has a clear impact on the profitability of the company. In order to improve the ethical climate of an organization, management must effectively communicate proper ethical behavior throughout the organization. Training sessions, codes of Journal of Academic and Business Ethics International Business Ethics, Page 3 ethics, reward systems, and coaching are a few methods that organizations employ in this regard. Therefore, the problems that organizations face today are: How ethical values are communicated most effectively to employees? Which communication channel works best?

American business in spite of all of its faults and weaknesses, still form a key model for much of the world. An important force in disseminating the American style of management is the role of the U.S. as the world's largest manufacturer of contemporary culture. Moreover, many researchers have pointed to the significant role that the American business schools play in propagating the U.S. style of management throughout the world.

Ethics is the moral principle that individuals inject into their decision making process and that helps temper the last outcome to conform to the norms of their society. Moreover, ethical principles have the very profound function of making behavior predictable. The truly global companies must come to grips with the legal and moral atmosphere in which they operate.

But above all, they need to establish an environment that fosters ethical behavior, because in the final analysis to do otherwise cuts into their profitability.

In contrast to this view a group of scholars put forth the theory of Virtuous Ethics, which is defined as a theory that focuses mainly on an individual's moral character. According to these scholars, marketing researchers have paid little attention to virtuous ethics. Furthermore, they propose that without taking virtuous ethics into account, a comprehensive analysis of the ethical character of marketing decision makers and their strategies cannot be attained.

Areas that need Business Ethics:

Ethical codes that govern businesses often address certain main areas. These areas, as compiled by the NIEHS branch of the U.S. National Institutes of Health include:

(1) Honesty, (2) Objectivity, (3) Integrity, (4) Carefulness, (5) Openness,

(6) Respect for intellectual property, (7) Confidentiality, (8) Responsible publication,

(9) Responsible mentoring, (10) Respect for colleagues, (11) Social responsibility,

(12) Non-discrimination, (13) Competence, (14) Legality, (15) Human subjects protection

Benefits from ethical leadership:

More and more leaders of businesses and other organizations are now waking up to the reality of social responsibility and organizational ethics.

Public opinion, unleashed by the internet particularly, is re-shaping expectations and standards. Organizational behavior - good and bad - is more transparent than ever - globally. Injustice anywhere in the world is becoming more and more visible, and less and less acceptable. Reaction to corporate recklessness, exploitation, dishonesty and negligence it is becoming more and more organized and potent. Employers, businesses and organizations of all sorts - especially the big high profile ones - are now recognizing that there are solid effects and outcomes driving organizational change. There are now real incentives for doing the right thing, and real disincentives for doing the wrong things. As never before, there are huge organizational advantages from behaving ethically, with humanity, compassion, and with proper consideration for the world beyond the boardroom and the shareholders:

Competitive advantage - customers are increasingly favoring providers and suppliers who demonstrate responsibility and ethical practices. Failure to do so means lost market share, and shrinking popularity, which reduces revenues, profits, or whatever other results the organization seeks to achieve.

Better staff attraction and retention - the best staff want to work for truly responsible and ethical employers. Failing to be a good employer means good staff leave, and reduces the likelihood of attracting good new-starters. This pushes up costs and undermines performance and efficiency. Aside from this, good organizations simply can't function without good people.

Legacy - even the most deluded leaders will admit in the cold light of day that they'd prefer to be remembered for doing something good, rather than making a pile of money or building a great big empire. It's human nature to be good. Humankind would not have survived were this not so. The greedy and the deluded have traditionally been able to persist with unethical irresponsible behavior because there's been nothing much stopping them, or reminding them that maybe there is another way. But no longer. Part of the re-shaping of attitudes and expectations is that making a pile of money, and building a great big empire, are becoming stigmatized. What's so great about leaving behind a pile of money or a great big empire if it's been at the cost of others' well-being, or the health of the planet? The ethics and responsibility zeitgeist is fundamentally changing the view of what a lifetime legacy should be and can be. And this will change the deeper aspirations of leaders, present and future, who can now see more clearly what a real legacy is.

Investment - few and fewer investors want to invest in organizations which lack integrity and responsibility, because they don't want the association, and because they know that for all the other reasons here, performance will eventually decline, and who wants to invest in a lost cause?

Morale and culture - staff who work in a high-integrity, socially responsible, globally considerate organization are far less prone to stress, attrition and dissatisfaction. Therefore they are happier and more productive. Happy productive people are a common feature in highly successful organisations. Stressed unhappy staff are less productive, take more time off, need more managing, and also take no interest in sorting out the organisation's failings when the whole thing implodes.

Reputation - it takes years, decades, to build organizational reputation - but only one scandal to destroy it. Ethical responsible organizations are far less prone to scandals and disasters. And if one does occur, an ethical responsible organization will automatically know how to deal with it quickly and openly and honestly. People tend to forgive organizations who are genuinely trying to do the right thing. People do not forgive, and are actually deeply insulted by, organizations who fail and then fail again by not addressing the problem and the root cause. Arrogant leaders share this weird delusion that no-one can see what they're up to. Years ago maybe they could hide, but now there's absolutely no hiding place.

Legal and regulatory reasons - soon there'll be no choice anyway - all organizations will have to comply with proper ethical and socially responsible standards. And these standards and compliance mechanisms will be global. Welcome to the age of transparency and accountability. So it makes sense to change before you are forced to.

Suggestions:

Nowadays much is talked about value based governance, a concept which has ethical flavor. It is similar to management by values. Value based governance requires value creation in respect of shareholders, employees, customers and society. The following are some suggestions for creation of such value based governance.

1. A peer evaluation for each member of the Board.
2. Changing the attitude of managers and employees for implementation of business ethics.
3. Better balance of power between the management and the board.
4. Recruitment on merit basis.
5. Establishment of systems, structures and incentives to promote transparency which bring accountability.
6. Remuneration of senior management should be based on the principles of fairness, transparency and accountability.

7. Acceptance of IAS-IFRS by all nations to compare the performance of corporations in a global environment.
8. The ICAI should implement a rule regarding a rotation of audit firms within two years to avoid their undue influence.
9. SEBI should develop adequate expertise for analyzing financial statements to detect a fraud.
10. The ICAI or the Government should encourage the development of a whistle blowing committee so that anybody who finds anything doubtful or fishy about a company should report the same to the committee.

Conclusion

Corporate Governance determines how companies are governed, how executive actions are supervised and how a company is accountable to regulations imposed on it by law or other commitments to shareholders. Corporate governance is also concerned with the ethics, values and morals of a company and its directors.

"A business that makes nothing but money is a poor kind of business"

A business, which wants to survive for a long term and also to generate good revenue, has to achieve market credibility by making brand loyalty as its main goal which can only be achieved by following ethical standards.

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