Corporate Governance and Business Ethics
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Index

Content........................................................................................................ II

List of Figures............................................................................................ VII

List of Tables............................................................................................. VIII

Abbreviations .......................................................................................... IX

Case Study ................................................................................................. 139

Bibliography ............................................................................................. 147

Self Assessment Answers .......................................................................... 150
Chapter I
Introduction to Corporate Governance

Aim .................................................................................................................. 1
Objectives ........................................................................................................ 1
Learning outcome ............................................................................................ 1

1.1 Introduction .................................................................................................. 2
1.2 The Purpose of Corporate Governance ....................................................... 2
1.3 The Drivers of Corporate Governance ....................................................... 3
    1.3.1 Reaction to Scandals/Misbehaviour .................................................. 3
    1.3.2 Reaction to Excessive Remuneration of Staff at the Top of Companies ................................................................................. 3
    1.3.3 Reaction to Competition .................................................................. 4
    1.3.4 Reaction to the Media ...................................................................... 4
1.4 Development of Corporate Governance to Date ......................................... 5
1.5 Codes Vs. Rules ........................................................................................... 6
    1.5.1 The Benefits and Drawbacks of Principle-Driven Codes .................. 6
    1.5.2 Rules ................................................................................................ 7
1.6 Achievements of Corporate Governance to Date ....................................... 8
1.7 Confidence in Share Valuations .................................................................. 8
1.8 Involvement of the Media and Activists ..................................................... 8
1.9 Shareholder Voting ..................................................................................... 8
1.10 Stakeholders ............................................................................................. 9
1.11 Problems of Corporate Governance which Remain ................................ 10
1.12 Agency .................................................................................................... 10
1.13 Executive Power and the Role of Independent Directors ......................... 10
1.14 Remuneration Excesses ........................................................................... 11
1.15 Audit ........................................................................................................ 11
1.16 Regulation ................................................................................................. 12
1.17 Competition Issues .................................................................................. 12
1.18 Risk Management .................................................................................... 12
1.19 Weakening of Shareholder Pre-emption Rights ........................................ 13
1.20 Insider Dealing/Corruption .................................................................... 13
1.21 Benefits Obtained To Date from Corporate Governance-Recognition of Need for Certain Standards .................................................. 13
1.22 Some Evidence of the Effect of Corporate Governance in Improving Business Results ............................................................... 14

Summary ........................................................................................................... 16
References ......................................................................................................... 16
Recommended Reading .................................................................................... 16
Self Assessment ............................................................................................... 17

Chapter II
The Global Pattern of Corporate Governance- Different Approaches and Cultures;
Winners and Losers

Aim ................................................................................................................... 19
Objectives ......................................................................................................... 19
Learning outcome ............................................................................................ 19

2.1 Introduction ................................................................................................. 20
2.2 Common Law Based Countries .................................................................. 20
    2.2.1 USA ................................................................................................ 20
    2.2.2 UK ................................................................................................ 22
    2.2.3 Canada ........................................................................................... 22
    2.2.4 Australia ........................................................................................ 22
    2.2.5 New Zealand ................................................................................... 23
    2.2.6 South Africa ................................................................................... 23
    2.2.7 Ireland ............................................................................................ 23
3.8.4 Management and Administration .......................................................... 51
3.8.5 Accounts of Companies ........................................................................ 51
3.8.6 Audit and Auditors ................................................................................ 52
3.8.7 Appointment and Qualification of Directors ........................................... 52
3.8.8 Meetings of Board and its Powers .......................................................... 53
3.8.9 Appointment and Remuneration of Managerial Personnel .................... 54
3.8.10 Inspection, inquiry and investigation ..................................................... 54
3.9 Corporate Governance Rating ................................................................... 54
Summary ........................................................................................................ 55
References ....................................................................................................... 55
Recommended Reading .................................................................................... 56
Self Assessment ............................................................................................... 57

Chapter IV ....................................................................................................... 59
Drivers for Corporate Governance and Resisters to Corporate Governance ........ 59
Aim .................................................................................................................... 59
Objectives ........................................................................................................ 59
Learning outcome ............................................................................................ 59
4.1 Introduction ................................................................................................ 60
4.2 External Drivers .......................................................................................... 63
4.2.1 Media ..................................................................................................... 63
4.2.2 Stakeholders .......................................................................................... 63
4.2.3 Activists ................................................................................................ 64
4.2.4 Regulations ............................................................................................ 64
4.3 Key Resistors of Corporate Governance .................................................... 65
4.3.1 Entrenched Power ................................................................................ 65
4.3.2 Hidden Agendas ................................................................................... 65
4.3.3 Resistance to Change ........................................................................... 65
4.3.4 Secrecy .................................................................................................. 65
4.3.5 Distrust/Mistrust .................................................................................. 66
4.4 Other Issues Driving Corporate Governance ............................................. 66
4.4.1 Cost ....................................................................................................... 66
4.4.2 Whistle-blowing .................................................................................... 66
4.4.3 The Value of Corporate Governance .................................................... 67
4.4.4 Government .......................................................................................... 68
4.5 The Present Balance of Forces in Corporate Governance ......................... 68
Summary ........................................................................................................ 69
References ....................................................................................................... 69
Recommended Reading .................................................................................... 69
Self Assessment ............................................................................................... 70

Chapter V ....................................................................................................... 72
Human Nature and Corporate Governance ...................................................... 72
Aim .................................................................................................................... 72
Objectives ........................................................................................................ 72
Learning outcome ............................................................................................ 72
5.1 Introduction ................................................................................................ 73
5.2 The Long-term Vs. Short-term ................................................................. 74
5.3 Hubris ....................................................................................................... 75
5.4 Criminality/Crime ..................................................................................... 75
5.5 Behavioural Challenges to Corporate Governance .................................... 76
5.5.1 Fraud ..................................................................................................... 76
5.5.2 Insider Dealing ...................................................................................... 77
5.5.3 Money Laundering ................................................................................ 77
5.5.4 Corruption ............................................................................................ 78
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter VIII</td>
<td>123</td>
</tr>
<tr>
<td>Environmental Ethics</td>
<td>123</td>
</tr>
<tr>
<td>Aim</td>
<td>123</td>
</tr>
<tr>
<td>Objectives</td>
<td>123</td>
</tr>
<tr>
<td>Learning outcome</td>
<td>123</td>
</tr>
<tr>
<td>8.1 Introduction</td>
<td>124</td>
</tr>
<tr>
<td>8.2 Environmental Ethics</td>
<td>124</td>
</tr>
<tr>
<td>8.3 History of Environmental Ethics</td>
<td>126</td>
</tr>
<tr>
<td>8.4 Development of Environmental Ethics</td>
<td>128</td>
</tr>
<tr>
<td>8.5 Human Beings</td>
<td>128</td>
</tr>
<tr>
<td>8.6 Animals</td>
<td>129</td>
</tr>
<tr>
<td>8.7 Individual Living Organisms</td>
<td>129</td>
</tr>
<tr>
<td>8.8 Holistic Entities</td>
<td>130</td>
</tr>
<tr>
<td>8.9 Earth Ethics</td>
<td>131</td>
</tr>
<tr>
<td>8.10 Radical Ecological Ethical Theories</td>
<td>131</td>
</tr>
<tr>
<td>8.10.1 Deep Ecology</td>
<td>132</td>
</tr>
<tr>
<td>8.10.2 Social Ecology</td>
<td>133</td>
</tr>
<tr>
<td>8.10.3 Eco-feminism</td>
<td>133</td>
</tr>
<tr>
<td>8.11 The Future of Environmental Ethics</td>
<td>134</td>
</tr>
<tr>
<td>Summary</td>
<td>136</td>
</tr>
<tr>
<td>References</td>
<td>136</td>
</tr>
<tr>
<td>Recommended Reading</td>
<td>136</td>
</tr>
<tr>
<td>Self Assessment</td>
<td>137</td>
</tr>
</tbody>
</table>
## List of Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fig. 6.1</td>
<td>Objectives of ethics</td>
<td>89</td>
</tr>
<tr>
<td>Fig. 6.2</td>
<td>Modified ethics types suitable for research organisation</td>
<td>91</td>
</tr>
<tr>
<td>Fig. 6.3</td>
<td>Traditional model of the organisation</td>
<td>92</td>
</tr>
<tr>
<td>Fig. 6.4</td>
<td>Factors influencing business ethics</td>
<td>96</td>
</tr>
<tr>
<td>Fig. 6.5</td>
<td>Steps to achieve increased organisational effectiveness</td>
<td>102</td>
</tr>
</tbody>
</table>
### List of Tables

Table 2.1 Rankings by ethics and sustainability ................................................................. 32  
Table 4.1 The forces impacting on corporate governance .................................................. 61  
Table 6.1 Ethical influence on business ............................................................................. 98
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACGA</td>
<td>Asian Corporate Governance Association</td>
</tr>
<tr>
<td>ADAM</td>
<td>Association de Defense des Actionnaires Minoritaires</td>
</tr>
<tr>
<td>AIMA</td>
<td>All India Management Association</td>
</tr>
<tr>
<td>ASCE</td>
<td>American Society of Civil Engineers</td>
</tr>
<tr>
<td>BISS</td>
<td>Business, Innovation and Skills</td>
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<tr>
<td>CASE</td>
<td>Cairo and Alexandria Stock Exchange</td>
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<tr>
<td>CII</td>
<td>Confederation of Indian Industry</td>
</tr>
<tr>
<td>CMB</td>
<td>Capital Markets Board</td>
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<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>CST</td>
<td>Collins Stewart Tullett</td>
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<tr>
<td>ECPED</td>
<td>Engineers’ Council for Professional Development</td>
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<tr>
<td>EU</td>
<td>Eighth Directive</td>
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<tr>
<td>EVA</td>
<td>Economic Value Added</td>
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<tr>
<td>FSA</td>
<td>Financial Services Authority</td>
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<td>FT</td>
<td>Financial Times</td>
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<tr>
<td>GCC</td>
<td>Gulf Co-operation Council</td>
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<tr>
<td>HMRC</td>
<td>Her Majesty’s Revenue and Customs</td>
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<tr>
<td>ID</td>
<td>Independent Directors</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<tr>
<td>IGAAP</td>
<td>International Generally Accepted Accounting Practice</td>
</tr>
<tr>
<td>IOD</td>
<td>Institute of Directors</td>
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<tr>
<td>LBO</td>
<td>Leveraged Buyout</td>
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<tr>
<td>LSE</td>
<td>London Stock Exchange</td>
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<tr>
<td>NAPF</td>
<td>National Association of Pension Funds</td>
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<tr>
<td>NCGC</td>
<td>National Corporate Governance Committee</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>OFT</td>
<td>Office of Fair Trading</td>
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<tr>
<td>OPA</td>
<td>Oferta Publica de Adquisicion Obligatoria</td>
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<tr>
<td>PRoNED</td>
<td>The Promoter Of Best Practice In Recruiting Non-Executive Directors</td>
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<tr>
<td>PSPD</td>
<td>People’s Solidarity for Participatory Democracy</td>
</tr>
<tr>
<td>RSA</td>
<td>Royal Society of Arts</td>
</tr>
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<td>RTS</td>
<td>Russian Trading System</td>
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<tr>
<td>SAPI</td>
<td>Sociedad Anonima Promotora de Inversion</td>
</tr>
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<td>SE</td>
<td>Societas Europea</td>
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<tr>
<td>SEBI</td>
<td>Securities and Exchange Board of India</td>
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<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>SFIO</td>
<td>Serious Fraud Investigation Office</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>SOX</td>
<td>Sarbanes-Oxley Act</td>
</tr>
<tr>
<td>SWF</td>
<td>Sovereign Wealth Funds</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
</tbody>
</table>
Chapter I
Introduction to Corporate Governance

Aim
The aim of this chapter is to:

• introduce corporate governance
• explain the purpose of corporate governance
• explicate the drivers of corporate governance

Objectives
The objectives of this chapter are to:

• explicate code v. rules
• elucidate the achievements of corporate governance to date
• explain the confidence in share valuations

Learning outcome
At the end of this chapter, you will be able to:

• identify the stakeholders
• understand agency
• describe executive powers and the role of independent directors
1.1 Introduction
Given that corporate governance often works against the grain of human nature, it has made considerable progress in some areas since it emerged as a public concern in the 1980s. At the heart of corporate governance is the tension between individual ambitions and the aspirations of society. This tension is inherent in any communal activity, and balancing individual and group interests is as challenging as riding a bicycle on a bumpy road.

1.2 The Purpose of Corporate Governance
Corporate governance has many definitions; depending on the scope it is granted. The Cadbury Committee Report in 1992 had a clear but narrow definition, “Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and auditors and to satisfy themselves that the appropriate governance structure is in place.” This definition focuses on directors and shareholders, with shareholders devolving authority to directors and employing auditors to underpin control.

In recent years, the scope of corporate governance has widened because of the growing recognition of the key role of companies as the wealth creators of society and of the wide range of stakeholders who are affected by their performance. The UK Companies Act 2006 now recognises stakeholders and their relationship with companies. Stakeholders are recognised in the World Bank definition of 1999, which has both a corporate perspective and a public policy perspective. “From the standpoint of the corporation, the emphasis is put on the relations between the owners, management board and other stakeholders (the employees, customers, suppliers, investors and communities). Major significance in corporate governance is given to the board of directors and its ability to attain long-term sustained value by balancing these interests. From a public policy perspective, corporate governance refers to providing for the survival, growth and development of the company and at the same time, its accountability in the exercise of power and control over companies. The role of public policy is to discipline companies and, at the same time, to stimulate them to minimise the differences between private and social interests.”

Such a definition sets corporate governance in a much wider context, particularly as companies are increasingly involved in global issues, such as climate change, human rights and resources sustainability. Many large companies have developed corporate social responsibility programmes to involve themselves in such issues, with limited evidence of success to date. The purpose of corporate governance has also evolved over time. The Organisation for Economic Co-operation and Development (OECD) saw the purpose of corporate governance in 1999 as follows:

- To protect shareholders’ rights.
- To ensure the equitable treatment of all shareholders.
- To recognise the rights of stakeholders as established by law and promote the concept of good corporate citizenship.
- To ensure that timely and accurate disclosure is made of all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.
- To ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.

This framework remains valid, despite some potential internal conflicts, but, like the evolving definition of corporate governance, a wider framework is now needed. Corporate governance should not be used as a vehicle for advancing social justice or any purposes which conflict with its key purpose of wealth creation. Nevertheless companies need to promote the concept of good corporate citizenship in support of their mission of creating wealth, not just obeying the law but by building a reputation for trustworthiness. Dealing with corruption is one of the core tests of effective corporate governance; fair and equal treatment for people involved with the company is another talisman of good governance. The ultimate purpose of corporate governance is to ensure the long-term survival of the company and this can only be achieved by making it indispensable to all who deal with it, rather like the ‘really useful’ storage boxes which are at the core of civilised living and enable us to survive a crowded and busy lifestyle. It is the complexity and pace of modern business life which makes effective corporate governance increasingly essential for survival. Without it we face the fate of Enron, Barings Bank or Bear Stearns.
1.3 The Drivers of Corporate Governance

Unless and until it becomes self-sustaining, corporate governance needs to be impelled and shaped by a number of ‘drivers’. These may vary between companies at the margin, but the core drivers include the following:

- Reaction to scandals or misbehaviour
- Reaction to excessive remuneration for the staff at the top of companies
- Reaction to competition
- Reaction to the media

1.3.1 Reaction to Scandals/Misbehaviour

It was the frequency of scandals in City quoted companies which led to the Cadbury Enquiry Report at the end of the 1980s. In the USA, it was the activity of corporate raiders, such as KKR and T Boone Pickens which stimulated interest in corporate governance. Scandals have also impelled corporate governance in the Netherlands (Ahold), Switzerland (Swissair), Italy (Parmalat), Japan (Nissan) and elsewhere. Most countries deal with their crises behind closed doors, so that they do not erupt as scandals. Crédit Lyonnais was brought to the brink of bankruptcy by uncontrolled expansion; similar hubris led to the restructuring of Lyonnaise des Eaux, but both were dealt with ‘behind closed doors’.

It had been hoped that scandals would be less frequent and severe in the twenty first century as corporate governance inhibited their gestation. The emergence of Enron, WorldCom, Tyco and other scandals in the USA, with Ahold and Parmalat in Europe, has demonstrated that scandals and misbehaviour are abiding risks in the corporate world. The growth in criminality globally is a key driver of corporate misdemeanour. In general, it acts as a brake on economic progress in countries where criminals can exercise political power, but can be a spur to improve governance where power is more diffused and its exercise is subject to scrutiny.

1.3.2 Reaction to Excessive Remuneration of Staff at the Top of Companies

With the retreat of socialism, there has been a growing acceptance that rewards may be unequal and that outstanding contributors deserve outstanding rewards. Actors in blockbuster films and outstanding athletes have long enjoyed a pay that reflects their personal contribution to the wealth created. On the other hand, opportunists throughout history have enriched themselves excessively and some have been able to pass their plunder to later generations. India, for example, has been pillaged by a succession of opportunists of whom Lord Clive was only one of the most successful and most envied.

As the world has become better informed and cooperation is essential for wealth-creation, self-enrichment has been subject to scrutiny. The trusts set up by J P Morgan and others in nineteenth-century USA created polarities of power which had to be broken up to protect society. Ever since, entrepreneurs and putative cartels have been watched to detect incipient abuse and action has been taken, as with Microsoft, where market dominance is unreasonably exploited. The public is suspicious of ‘tall poppies’ and is usually pleased to see them cut down to size.

This sense of fairness is reflected in public attitudes to executive pay. Until around twenty years ago directors’ pay was typically some twenty times that of shop floor workers. This differential was tolerated where company performance was strong and society reflected the views of J P Morgan a century ago on the balance of risk and reward. A survey by The Guardian newspaper in 2007 showed an average boss: worker differential of 66:1 (based on salary alone) and 98:1 with other incentives. In South Africa a 2006 survey by COSATU complained of a 53:1 ratio, whereas in the USA the IPS/UFE 2007 CEO compensation survey showed large company CEOs enjoying a 364:1 ratio, earning in one day the annual pay of the average American worker, before pensions and other perquisites.

This egregious excess is justified by recipients and rewards consultants as the price of ‘leadership’. Few attempt to define this concept; despite a plethora of literature on the subject, there is no generally accepted definition of ‘leadership’ and little attempt to measure it. The power of CEOs is based on the Napoleonic model of leadership, the single galvanising force who drives his/her organisation to exemplary success. This model is increasingly challenged, both because of the leader’s total dependence on effective and loyal followers and because hubristic leadership has
invariably ridden before a fall. The issue of remuneration is a key factor in the examination of sustainability since effective governance depends crucially on the support of all stakeholders and remuneration which does not reflect the real contribution of their recipients.

1.3.3 Reaction to Competition
Monopolies are rarely models for corporate governance. External challenge is healthy for all organisations, forcing them to reappraise their performance and adopt better practices. Lack of external challenge makes organisations inward-looking and tends to encourage internal politicking. This phenomenon can be seen in some of the major utilities and in airlines like Alitalia. Even a world champion like Coca Cola is kept alert by the presence of Pepsi, and the epic struggle between Boeing and Airbus leaves neither with any respite from meeting new challenges.

Companies facing intense competition are forced to maximise productivity and to innovate to maintain profitability. Competition is the visible working of Adam Smith’s ‘invisible hand’ and creates the pressures which can only be sustained by effective corporate governance. Companies like Rolls-Royce survive by constantly renewing themselves, which demands value systems and operating processes to which all employees and other stakeholders are totally committed.

Competition itself is driven by change and needs constantly to adapt to new realities. Competition is the manifestation of a Darwinian struggle for survival of companies in a specific marketplace. It can be ‘destructive competition’ which seeks to eliminate all rivals and monopolise the market, or it can be ‘cooperative competition’ which seeks to expand the market for the benefit of all participants. Most companies would like to succeed in ‘destructive competition,’ but are restrained by costs and the fear of regulatory intervention if they become too dominant. This may be seen in the continuous attempts by Intel to marginalise competition from AMD in the computer chip market. ‘Cooperative competition’ can also be hazardous when it involves the creation of cartels or agreements in restraint of trade. Keeping competition honest or substituting for a lack of competition where utilities exercise a ‘natural monopoly’, is a key role of regulators.

1.3.4 Reaction to the Media
Referring to the media as the ‘fourth estate of the realm’ recognises their pervasive power in society. The media is also a stakeholder in most organisations, rarely at the wish of management, but as ineluctable as Her Majesty’s Revenue and Customs (HMRC). The media is rarely passive and pursue an agenda largely of self-interest. The media drives corporate governance, not primarily to improve society, but to embarrass the targets which their audience distrusts and to maintain their audience’s custom. The media frenzy over Northern Rock had little to do with protecting savers, but everything to do with embarrassing Gordon Brown and his government.

In the context of corporate governance, therefore, the media seeks stories of scandal, of greed and of incompetence which will resonate with their audience. The media drives corporate governance through revealing hidden misfeasance, not by stimulating best practice. The media is adept and persistent in revealing complex plots, notable in the case of Watergate and of BCCI in a business context. Many cartels and price-fixing arrangements have been uncovered by the media, which earlier drove the movement to break up major trusts in US business such as Standard Oil.

The media does not always have a free hand in dealing with companies. A key part of the revenue of most media is advertising, much of it paid for by businesses; where the media has critical stories to tell about such businesses, they face an immediate conflict of interest. ‘Publish and be damned’ may be a dramatic and principled reaction to such a dilemma, but is unlikely to be typical. Perversely it may be the media which drives corporate governance effectively not by intent, but through their unceasing fascination with wealth and the flow of stories which it generates. The other unrelenting driver of good governance is competition, fed by the ‘invisible hand’ of Adam Smith and the interplay of human nature.
1.4 Development of Corporate Governance to Date

The original Code of Best Practice of December 1992 was derived from the Cadbury Report, issued as a draft earlier that year. The focus of the Code is primarily on the financial aspects of corporate governance, highlighted by the scandals which had prompted the commissioning of the Cadbury Report.

Early experience of using the Code showed weakness in dealing with directors’ remuneration, which the Cadbury Code had entrusted to a Remuneration Committee of the board, following guidelines from PRoNED (the promoter of best practice in recruiting non-executive directors). In order to address this issue in greater detail, a study group was established under the chairmanship of Sir Richard Greenbury, then Chairman of Marks and Spencer plc, which reported in July 1995. ‘Directors’ Remuneration’ was the second corporate governance report in the UK and it too had a Code of Best Practice, focusing on the Remuneration Committee of the board, Disclosure and Approval Provisions, Remuneration Policy, and Service Contracts and Compensation. The Code seeks to take directors’ remuneration out of the hands of prospective beneficiaries and empower non-executive directors to use auditors and outside experts to guide policy and provision.

The Cadbury and Greenbury Codes were reviewed and consolidated into the Combined Code following an assessment of progress to date by a committee led by Sir Ronald Hampel, then Chairman of ICI plc. This committee reported in January 1998 and the Combined Code was issued in June 1998. The thrust of the report is clear from its opening paragraph, ‘The importance of corporate governance lies in its contribution both to business prosperity and to accountability. In the UK, the latter has preoccupied much public debate over the past few years. We would wish to see the balance corrected.’ A decade later, corporate governance remains over-focused on process and is underachieving in building strong and sustainable business performance.

Part of this failure to redress the balance may be attributed to the work of the Internal Control Working Party, set up by the Institute of Chartered Accountants in England and Wales, to provide detailed guidance on implementing the provisions of the Combined Code relating to internal control. The so-called Turnbull Report focused on different aspects of business risk and required an annual statement of risks identified and of the actions taken to manage them. This requirement led to the establishment of Risk Management Departments in major companies and to compliance procedures within the business to avoid risks. Many companies developed elaborate models of risk to guide business decisions; it is unfortunate that most of these models used only historical evidence and failed to identify new risks or changing patterns of risk. Lack of understanding of derivatives and other new trading techniques contributed to the debacle over sub-prime mortgages, which created the banking crisis of 2007.

The Combined Code was revised in 2003 in the light of two other reports, the Higgs Report on the use of non-executive directors and the Smith Report on auditing. Both were issued earlier in the same year as the new Combined Code. The Higgs Report confirms the work of earlier reports and develops the role of non-executive directors in the working of the board and its committees. Higgs expands this role both by prescribing that boards should have a majority of non-executive directors and by detailing arrangements for their appointment and activities. He also re-emphasises the need to split the roles of chairman and chief executive, and creates the role of senior independent director, who meets a new test of the independence required of a majority of board directors.

The Smith Report of January 2003 focuses on accounting and audit arrangements. It strengthens the role of the Audit Committee of the board by requiring, for larger companies, at least three independent directors to be members, with at least one member having ‘significant, recent and relevant financial experience’. The Audit Committee is to have free access to information it requires on individuals and its activities are to be detailed in the company’s Annual Report. The Audit Committee oversees internal controls, internal audit and statutory audit arrangements. The use of auditors for non-audit work is subject to stringent control. No specific provision is made for the rotation of auditors (as in the Sarbanes-Oxley Act in the USA) and this remains an unresolved issue in the UK. In 2006, a new Companies Act was passed by Parliament after many years of gestation. The new Act replaces the Companies Act 1985 after 21 years of considerable change in corporate governance. In 1985, the term ‘corporate governance’ was not used and companies existed to fulfil the wishes of their shareholders. One key change in the new Act is the recognition of ‘stakeholders’ in the company other than shareholders. This is symptomatic of a major change in the role of companies in society and of the legal framework within which companies are directed. The 2006 Act
differentiates more clearly between the provisions for large and small companies, and between quoted and private companies. The regulatory burden of small and private companies is reduced in some respects, for example private companies do not need to have an AGM and may dispense with a company secretary. All companies can now make increased use of electronic media to communicate with shareholders and other stakeholders, bringing the law into line with modern practice.

In order to update the combined code and reflect lessons from the 2008 economic crisis, the Financial Reporting Council issued a revised UK code in June 2010. This applies directly to listed companies and drives tighter compliance or clearer explanation of the reasons for non-compliance, in part to draw shareholders closer to the governance of their company.

1.5 Codes Vs. Rules

One key feature of corporate governance in the UK and some Commonwealth countries is a reliance on principles rather than rules. This approach shapes the Cadbury Code and is found in the contemporaneous ‘Standards in Public Life’ established by the Nolan Committee for the public sector. Nolan distilled ‘Seven Principles of Public Life’ to act as touchstones for its series of inquiries in the public sector. These are as follows:

- Selflessness: Acting solely in the public interest.
- Integrity: Avoiding obligations to third parties.
- Objectivity: Making judgements solely on merit.
- Openness: Explaining actions fully, restricting information only to protect the public interest.
- Honesty: Declaring any private interests which may conflict with the public interest.
- Accountability: Being open to any scrutiny appropriate to the office held.
- Leadership: Setting an example in observing these Principles punctiliously.

The Cadbury Code echoes most of these principles, but ‘selflessness’ and ‘objectivity’ are notably absent. Another set of principles was established by the OECD in 1998. These are as follows:

- Fairness: Protecting shareholder rights and ensuring contracts with resource providers are enforceable.
- Transparency: Requiring timely disclosure of adequate information on corporate financial performance.
- Accountability: Ensuring that management and shareholder interests are kept in alignment; responsibility ensuring corporate compliance with laws, regulations and society norms.

At first sight ‘fairness’ seems to be lacking in the Nolan Principles, yet it has some affinity with ‘selflessness’ if shareholders are substituted for the public.

1.5.1 The Benefits and Drawbacks of Principle-Driven Codes

The Cadbury and other committees which completed earlier inquiries into corporate governance were conscious that their work was exploratory and not definitive. They were not seeking to draft legislation, but to provide guidance to businessmen who sought best practice in a world of conflicting interests. In shaping Codes, they were indicating guidelines which were consistent and coherent but which users could modify to meet the specific needs of their companies. These Codes became mandatory for quoted companies and were replicated in the Listing Rules; for all companies the requirement is to ‘comply or explain’, but there is greater latitude for smaller companies. ‘Comply or explain’ ensures that shareholders have a complete picture of compliance with the Code and can evaluate the Company Annual Report as a whole.

Principle-driven reporting encourages the best companies to go beyond compliance with the Code to demonstrate better practice and build trust. Principle-driven reporting puts an onus on boards to open their company to public scrutiny and to answer questions they may not welcome. It makes it more difficult to hide problems, such as Nike’s use of child labour in the Developing World, or to conceal unfair or corrupt practices. Many companies fear that openness will give an advantage to competitors or invite inspection from a government agency. In fact, greater openness facilitates business contacts and builds company reputation. Codes offer the opportunity to demonstrate the soundness of a company and to move beyond compliance to show distinction.
1.5.2 Rules

Superficially rules appear to offer certainty and clarity where codes, interpreted through principles, are imprecise. Rules are not meant to be interpreted, since they are absolute. The Ten Commandments are rules. ‘Thou shall not kill’ is not meant to be interpreted, but is subject to prevarication on nearly every occasion. The law is a framework of rules yet the courts resound to endless debate in clarifying them. Rules stimulate litigation as parties seek to exempt themselves from obeying them. A rules-based approach to governance is typified by the US Securities and Exchange Commission (SEC). Its mission is ‘to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation’. Its approximate partial equivalent in the UK is the Financial Services Authority (FSA), which regulates with a zeal which may be tempered where its trust in a company has been earned by consistent performance.

The SEC’s regulation of the Securities Industry is based on the following key statutes:

- Securities Act 1933
- Securities Exchange Act 1934
- Trust Indenture Act 1939
- Investment Company Act 1940
- Investment Advisers Act 1940
- Sarbanes-Oxley Act 2002

These statutes are regulated through a series of ‘Rules of Practice’ and are continuously interpreted through litigation. The SEC requires that all securities should be offered with a detailed prospectus and that all information about changes affecting the securities and their valuation should be made fully and promptly available to investors. The SEC was created to prevent any recurrence of the Crash of 1929 and operates a strong post hoc precautionary principle to avoid any risks to US capital markets. Escaping from the zeal of the SEC is a key contributor to the growth of private equity and non-regulated activities such as hedge funds. This zeal has been intensified by the administration of the Sarbanes-Oxley Act 2002, which has targeted corporate and accounting fraud and created a bureaucracy which has encouraged many US companies to register offshore.

The British FSA took over the regulatory role of the Bank of England and has the following four statutory objectives under the Financial Services and Markets Act 2000:

- Market confidence: Maintaining confidence in the financial system.
- Public awareness: Promoting public understanding of the financial system.
- Consumer protection: Securing the appropriate degree of protection for consumers.
- The reduction of financial crime: Reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

The process of regulation is laid down in the Act, but is guided by a set of ‘principles of good regulation’ which cover the following:

- Efficiency and economy in the use of resources committed to regulation.
- Role of management: Puts the onus for risk management and controlling their business on the management of the company, not the Financial Services Authority (FSA).
- Proportionality: The FSA exercises cost-benefit analysis of all restrictions imposed on companies.
- Innovation: Compliance should not impede new products or services.
- International character: Regulating to best international standards without undermining the competitiveness of companies in world markets.
- Competition: Need to facilitate competition and innovation, while avoiding adverse effects from FSA restrictions.
The Treasury, Office of Fair Trading and Competition Commission oversee the impact of FSA rules and practices on competition. The ‘Principles of Good Regulation’ are used to avoid an over-zealous or too prescriptive approach to regulation, so that the process of wealth creation is not impeded by unnecessary bureaucracy. Like a good referee, the FSA tries to keep the play going and only intervenes when fairness demands.

The light approach to regulation of the FSA has helped to build the market leadership of the City of London in recent years. The crisis caused by the ‘bubble’ of bank lending was international in scope and reflects badly on regulation in the USA, UK and elsewhere. Neither the rules-based regime of the SEC or the light touch approach of the FSA proved effective in preventing serious damage to the financial system. The key regulatory powers of the FSA are now exercised once more by the Bank of England.

1.6 Achievements of Corporate Governance to Date

The recent financial crisis is a wakeup call to those who believe that corporate governance is operating effectively in the world’s major economies. It demonstrates that much of the process of corporate governance is only skin deep and that managements too often pursue strategies which are unsustainable in the longer term. The crisis has revealed the hollowness of much of the risk management structure set up after the Turnbull Report and of the compliance infrastructure created by financial services companies. Despite this signal setback, some progress has been made in corporate governance in recent years.

1.7 Confidence in Share Valuations

The quality of company reporting has improved significantly, both through listing and other regulatory requirements and through companies’ desire to improve trading in their shares (for competitive, bonus and other reasons). Greater care has been taken in explaining the activities underpinning share values and companies are concerned to show a consistent and reliable pattern of growth in share value rather than reveal volatility. Companies such as Reckitt Benckiser have managed their growth over the longer term and have gained a reputation for reliability.

1.8 Involvement of the Media and Activists

Corporate governance has achieved a higher profile and some aspects have generated media interest. Takeovers and directors’ pay are now given greater coverage and it is increasingly difficult to hide good stories. Inter-shareholder feuds have created excitement, for instance, the Ambani brothers’ struggle for supremacy in India. The rise of shareholder activism contrasts with the ‘sell and forget’ attitude of earlier times. This was stimulated first by Calpers in the USA and PIRC (Pensions Investment Research Consultants) in the UK, but they are now joined by Knight Vinke in the USA. Most successful activists base their activity on detailed research; some move beyond a shareholder position towards seeking to influence company governance, often as members of the board. Carl Icahn is notable in this regard; he recently forced his way onto the board of Yahoo. T Boone Pickens has been active in this manner for many years, initially as a ‘corporate raider’. Daniel Loeb attacks the CEOs of target companies in sharply written letters. One of the most successful activists is Hermes, the pension fund, which follows its key investments closely and, in exceptional cases, intervenes to steer improvements in governance.

1.9 Shareholder Voting

For many years, shareholder voting has been a backwater. Few shareholders attended company meetings in person; many gave a proxy vote to the chairman of the meeting whose use of such votes was not subject to close scrutiny. Votes cast averaged some 30 per cent of entitlement. Most shares in The Organisation for Economic Co-operation and Development (OECD) countries are held by institutions, investment and pension funds primarily, and their record in voting has not been much better than that of private shareholders in past years. An early influence towards better voting participation has been PIRC, who advises institutional investors on how to use their votes to improve governance in the companies in which they invest. Prior to each quoted company’s AGM, they issue detailed recommendations on voting for each proposal based on thorough research and inter-company comparisons. Opposition to the appointment of Sir Stuart Rose as Chairman and CEO of Marks and Spencer was marshalled by PIRC and other activists.
The involvement of pension funds in voting their shares has been encouraged for some years by the National Association of Pension Funds (NAPF), which commissioned Lord Myners in 2001 to develop guidelines for their members. The ‘Myners Principles’ have become a further influence on voting patterns, although their main purpose is to improve the overall governance of pension funds. Myners has been successful in encouraging the use of election voting in FTSE 100 companies and this is beginning to spread to smaller companies.

The ownership of shares has become more complex since 2001, with the growth of hedge funds, private equity and sovereign wealth funds round the world whose activities are out of the public gaze and unregulated. The growing practice of borrowing shares from other investors is a further complication, which also produces further confusion over ownership in the marketplace. The 2006 Companies Act provides reserve powers for the government to force institutional shareholders to reveal their voting patterns. This issue has become contentious as there has been growing concern that institutional shareholders tend to support incumbent management in companies in which they invest, rather than vote on issues in the interest of the company itself. The Act also provides for AGMs in private companies to be optional.

Another reforming agent is the pending EU directive on shareholder voting rights. This follows from a study by the EU Commission which revealed the contorted pattern of voting rights, and restrictions on exercising them, practised in Europe. The purpose of the directive is to move towards a ‘one share, one vote’ norm, which has overwhelming support among European investors. Shareholder voting remains a matter of contention, but is beginning to move towards workable practice. A decade ago, it was characterised by indifference.

1.10 Stakeholders

‘The stakeholders in a corporation are the individuals and constituencies that contribute either voluntarily or involuntarily, to its wealth creating capacity and activities, and that are therefore its potential beneficiaries and or risk bearers’ (Post, Preston and Sachs 2002). The range of stakeholders commonly recognised includes the following:

- Shareholders
- Employees/trades unions
- Directors
- Customers
- Suppliers
- Creditors
- Competitors
- Government/regulators
- Communities
- Families educational
- Establishments
- Industry trade groups
- Public services

The following also may be included (by self-imposition rather than choice in many cases):

- The media
- NGOs/charities

Recognition of the role of stakeholders was advanced by the ‘Tomorrow’s Company’ Inquiry, led by the Royal Society of Arts (RSA) and published in 1995. This emphasised the need for an ‘inclusive approach’ to company direction, identifying and involving a range of shareholders wide enough to enable the company to gain and retain a ‘licence to operate’ from society as a whole. This approach is much wider than that taken in earlier Companies Acts or in the early Codes, but stakeholders are explicitly recognised in the 2006 Companies Act and in the corporate social responsibility (CSR) movement which grew out of the ‘Tomorrow’s Company’ process and wider ecological and sustainability concerns.
Corporate Governance and Business Ethics

Corporate social responsibility also links with the growth of shareholder activism. It is now supported by the UK government and many FTSE 100 companies issue special annual reports to demonstrate their commitment to satisfying the demands of their wide range of stakeholders. Even ExxonMobil, for long the model for liberal capitalism, now has a Corporate Citizenship Report. The company rightly emphasises that its ‘primary role and the most important benefit to society is to safely provide reliable and affordable supplies of energy to people around the world’. Usage of the word, ‘stakeholders’ is sparse. ExxonMobil focuses primarily on shareholders. Contrasting with ExxonMobil is the Statement on CSR from the Caux Round Table Scholars’ Retreat in July 2008. This emphasises the ethical dimension of CSR in a context of challenges to global sustainability. The Statement is reproduced in Appendix 1.

1.11 Problems of Corporate Governance which Remain

Some of the achievements of corporate governance which are real have been examined. This reveals some new challenges to be met. Some of the other problems seem to be more intractable and many require significant changes in human behaviour, if progress is to be made towards solving them. Such problems include directors’ remuneration and the dilution of the excessive power of executive directors. It is useful to examine these problem areas in more detail.

1.12 Agency

At the heart of issues of board performance is the issue of agency. Directors are the agents of the company, which is owned by its shareholders. They are subject to the laws of agency and answerable to their principal, the company embodied in its shareholders. Unfortunately, agency is an area of law which has suffered a great deal of erosion in recent years. A non-trivial example is the move by auction houses to charge commission both to sellers and buyers. This is contrary to the principle of law which precludes agents from acting in the same transaction for more than one principal. Another basic tenet which has eroded is ‘delegatus non potest delegare’, an agent may not delegate his agency without the prior agreement of his principal. This tenet is ignored on a daily basis in a wide range of commercial transactions, e.g., by substitution of personnel. Given this wide erosion of agency law, it is not surprising that directors frequently act as though they are principals, not least in manipulating their pay and perquisites, the cost of which falls on their principal. Where Remuneration Committees are in place and properly constituted, they can act as a brake on such practices, but not all companies have them.

Changing this corrupt behaviour will require a complete change of attitude, so that directors recognise that in the context of their appointment they are the servants of their principal. We have lost the idea of service as a noble calling rather than drudgery. ‘Public service’ has lost its cachet of standing and responsibility to become a target of complaints. Service is not demeaning, but is the impulse which sustains a civil society.

1.13 Executive Power and the Role of Independent Directors

The erosion of the agency principle and the increasing remoteness of shareholders from their company’s operations have combined to concentrate power in the hands of executive directors. Earlier concentrations of company power, in the big US trusts and in some earlier scandals (e.g., BCCI, Polly Peck, etc.), were driven by owner directors so that the victims were the public and/or minority shareholders. Recent scandals (e.g., Enron, WorldCom, etc.) have been driven by executive directors who have exploited their company for their own ends and misled shareholders about company performance. In the recent past, there has been a succession of hubristic CEOs who have concentrated power in their own hands, usually with damaging consequences. One extreme example is JeanMarie Messier, who over-expanded Compagnie Générale des Eaux to create a global conglomerate which was unsustainable and crashed with a loss of $11.8 billion in 2001. Lord Simpson became Managing Director of GEC plc in 1996 and took control on the retirement of Lord Weinstock. He forced the sale of the company’s lucrative defence business and concentrated resources in the telecom industry, buying at the market peak in 2001. As a result Marconi (as the company was renamed) lost 95 per cent of its value, some £33 billion. These extreme examples typify hundreds of other smaller cases of corporate damage through executive hubris.
The increasing power of executive directors and the emergence of star-quality CEOs were permitted by the relatively poor quality of non-executive directors. This phenomenon was due to a frequent negligence in their selection, to a tendency to underpay them and a lack of interest in briefing and using them. Some agencies, such as PRoNED, sought to promote the proper selection and use of non-executive directors, but their impact was uneven and focused on major companies. Among smaller firms, non-executive directors were mainly used to support the chairman and to impress shareholders through their titles and connections. A later pattern developed to support the newly appointed CEOs; this involved creating a network of CEOs acting as each other’s non-executive directors to provide mutual support. A key result of this development was a general escalation of CEO remuneration through Remuneration Committees filled with CEO non-executive directors.

The need to improve the performance of non-executive directors and rebalance their weight in the board’s deliberations in comparison with the preponderance of executive directors led to the appointment of the Higgs Committee in 2001. The report of this committee was published in 2003 and raised the role and influence of ‘independent’ directors significantly. ‘Independent’ directors are placed in control of key committees of the board ‘independent’ being defined as ‘independent in character and judgement’ and without other relationships to the company or persons within it. Quoted companies are now required to have a majority of independent non-executive directors, and the Combined Code has detailed provisions for their recruitment, training, activities and assessment. Non-executive directors now have a prime role in appointing, assessing and, if necessary, removing executive directors, so that the balance of power on the board should be restored and become stabilised.

1.14 Remuneration Excesses

Remuneration concerns have been identified earlier as a key issue for corporate governance. For many years, the differential between CEO and shop floor pay remained at a level which broadly reflected the relative contribution to company profitability of each role. In recent years, the media and remuneration specialists have put a spotlight on the issue of pay and stimulated greed among executive directors. The high rewards for star sports people have set unrealistic benchmarks and inter-company comparisons have ratcheted up levels of pay beyond the relative contribution of recipients. As a result, we have seen Dick Grasso, former CEO of the New York Stock Exchange, receiving $140 million for being dismissed from a largely symbolic appointment. In the business world, CEO’s daily pay can now equate to a whole year’s earnings on the shop floor. Such remuneration is not always geared to success, Terry Semel of Yahoo earned $72 million in 2006, but the company is now struggling to compete with Google. Stan O’Neal of Merrill Lynch earned $46 million in the same year as his company pushed into sub-prime excesses. The 2006 level of remuneration of private equity firms and hedge fund CEOs was 20 times that of quoted companies in the USA, taking excesses into the stratosphere. Perhaps only a major recession can bring order into this madness; the banking crisis seems to have failed to do so.

1.15 Audit

Audit is crucially important for corporate governance, both to ensure the health of company operations and to deter or uncover fraud. To be effective, auditors must be independent of company management, yet have inside knowledge to interpret their findings correctly. This requires audit personnel to gain experience of working with the company without such closeness allowing them to be ‘captured’ by company management. To avoid ‘capture’, it is usual to rotate audit staff. In the USA, the auditor itself must change every five years (Sarbanes-Oxley Act 2002). There are now only four global auditors, geared to handle large company international audits, so that the choice of auditor is limited, largely by prejudice of clients, rather than the true competence of medium-sized audit firms. The actual performance of auditors may have declined in recent years, if only on the evidence of the growth in successful litigation against them. The importance of audit and its present problems is a major challenge to companies. This has been helped by the work of the Smith Committee, published in 2003, which creates a strengthened Audit Committee of the board, with a majority of independent non-executive directors (one with current expert knowledge of finance) and a commitment to plan the audit cycle in depth and review the outcome with care. The new Audit Committee arrangements are integrated with the Turnbull provisions for ensuring effective internal control.

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1.16 Regulation

Regulation is difficult when the companies regulated can afford to pay significantly better salaries than those which staff receives. The intellectual tussle between regulator and regulated is paralleled at the extreme by the battle of wits between police and criminals. Bureaucracy is not the best weapon of regulators either, since it is time-consuming and engenders negative reactions. Bureaucracy can obscure the real issues within a regulated company, which the regulator needs to identify. Intuition is often the best weapon to enable a regulator to reach the heart of a problem; it must of course, be backed by scrupulous due process.

The record of regulation to date is mixed. Where regulators act as proxies for competition as with utilities, they have mainly helped to restrain market abuse without curtailing necessary investment. High prices for gas and electricity reflect supply constraints and are no more abusive than those of the unregulated oil industry. Financial services regulation has been less than successful worldwide, due to the actions of politicians in Asia and the Middle East, and due to ‘regulatory capture’ in the USA, UK and Europe. The financial crisis caused by excessive lending was foreseeable and yet little was done to restrain it. A significant share of responsibility for inaction lies with rating agencies which failed to adjust their ratings as risk escalated in the system. The crisis reveals a tendency in markets towards mass hysteria, which neither governments nor regulators had the will to resist.

1.17 Competition Issues

Managers pay lip service to competition, yet try constantly to avoid it. The first action in modern times to support competition was taken at the end of the nineteenth century in the USA by President McKinley, and followed up by Presidents Roosevelt and Taft. In all, well over 100 trusts were broken up and the Sherman and Clayton Acts passed to prevent their re-emergence. In Europe, the EU Commission has driven competition policy with vigour in pursuit of Articles 81/82 of the EC Treaty. The EU Competition Commissioner, Neelie Kroes, has pursued anti-competitive practice relentlessly, most notably with Microsoft, but also in the pharmaceutical and financial services sector. Cartels have also been broken up, most recently paper bleach producers who were fined €79 million for market and price fixing.

In the UK, the Competition Act 1998 has built on EU legislation and has given new powers to the Office of Fair Trading (OFT) to enforce the Act. The OFT works in collaboration with the Competition Commission and Trading Standards bodies. It is beginning to use its new powers with vigour, and is now offering financial incentives for information to identify cartels and amnesties for confessions. Despite some progress towards greater openness, the suspicion remains that prices, policies and actions remain concerted in many industries.

1.18 Risk Management

Risk and reward are two sides of the same coin. Business depends on a measured taking of risk, and daily life in society is full of risks (driving cars, making choices, crossing roads, etc.). If risk cannot be avoided, great care is needed in managing it. The bureaucratic approach to risk is to try to avoid it. The Health and Safety Executive has created a labyrinth of rules and regulations to avoid accidents. Their value may be gauged by comparing the accident record on a building site in the Developing World with one in the UK. Their cost is buried in the higher level of prices, which is a price that civil society is willing to pay.

Risk management has become a major industry in Western markets. In the UK, it was boosted by the Turnbull Report of 1999, leading to the appointment of risk managers in most firms of any size. Businesses subject to regulation have also needed to establish Compliance Departments to meet their obligations. Growing influence of the Precautionary Principle in managing resources, protecting health and protecting the environment adds to the burden of risk management for many businesses, although it is often manifested in corporate social responsibility reporting.

In recent years, there has been growing acknowledgement of the need to handle risks and considerable investment in attempting to do so. While accident rates have been reduced in many areas, there remains an attitude among many citizens of ‘it couldn’t happen to me’. This explains a generally cavalier attitude to insurance and reluctance to save in the UK; it also shapes business behaviours which resent controls on actions driven by personal ambition. Such behaviours drove the build-up of the financial bubble which has caused widespread damage to business and society. Where there is no general perception of risk, disaster is just round the corner.
1.19 Weakening of Shareholder Pre-Emption Rights

One basic tenet of company law has been the right of existing shareholders to have priority access to ‘rights’ issues of shares. The right has built shareholder loyalty and has limited the need to underwrite new share issues. The use of shares for takeovers has weakened pre-emption rights, but this use has been sanctioned by existing shareholders beforehand. Schemes to provide shares or share options for employees have also affected pre-emption rights, but have been approved by shareholders in advance. Pre-emption rights are enshrined by law in the EU Second Company Law Directive and the Companies Act 2006.

The European approach is based on the concept of property rights of shareholders which is lacking in the USA, where shareholder rights are more limited overall, e.g., board director elections. The US approach is to focus on the size of issue and speed of implementation, using professional placers to find buyers for the shares. This generates higher fees usually than the underwriting approach in the UK, the cost being borne by existing shareholders’ share valuations.

There are mounting pressures from bankers and other professionals to move towards an American approach to share placement. This is being resisted by the Pre-Emption Group of the Financial Reporting Council, the Association of British Insurers and others. There is little evidence that the European approach is hampering companies’ ability to raise new capital, and an EGM for shareholder approval is only a small extra step in the process. An example of success was the acquisition by Astra Zeneca of Cambridge Antibody Technology, which weakens pressures from the biotechnology sector to have pre-emption rights waived. The recurrent attempts to undermine the principle of pre-emption rights emphasise their real value to shareholders and should be vigorously resisted.

1.20 Insider Dealing/Corruption

Insider dealing is as old as commerce and undermines the concept of fair trading. All information has value to somebody and in an increasingly open society is liable to be stolen rather than paid for. The controversy over ‘free downloading’ of music from the Internet reflects the growing ambiguity about intellectual property. The same opportunistic mentality drives insider dealing, which is a facet of a wider problem of corruption and legally a fraud.

Insider dealing cases are conducted under the Criminal Justice Act 1987 and are usually pursued by the Serious Fraud Office in England, Wales and Northern Ireland. The burden of proof is very high, so that successful prosecutions are few. In the 2001 case of R v. Richard Spearman and others a second trial was needed in 2004 to convict the main defendant. In 2008, eight employees of UBS and Cazenove were arrested for insider dealing, but the ability to secure convictions remains uncertain despite some successes, e.g., Malcolm Calvert in March 2010. The FSA has found that 28.7 per cent of all takeover deals were preceded by suspect trading in 2007, up from 23.7 per cent in 2005. Until 2008, the FSA had failed to bring any single criminal prosecution for seven years. It is suspected that the latest arrests are a low-level token; the FSA does not know the higher-level network which drives most insider dealing. Lack of successful prosecutions makes it difficult to persuade suspects to cooperate with investigations and offers no deterrence to potential insider dealers.

1.21 Benefits Obtained To Date from Corporate Governance-Recognition of Need for Certain Standards

Twenty years ago corporate governance was not recognised as an issue. Company directors acted as agents for shareholders, but had wide discretion in how they managed the business. There were few challenges and problems were largely ‘brushed under the carpet’. From that time, business has become more complex and international, and shareholders and other parties dealing with companies have become more demanding. Media interest in companies has increased as employees become more mobile and financially aware. Concern about investment and pensions has grown as people are forced to become more self-reliant as State provision of services is eroded.
Consumers have become more aware of their rights in the last 20 years and less tolerant of poor service in the marketplace or from government. Efficiency has been demanded in the provision of services and certain standards are expected from providers. Companies are seen as providers of services and the range of their stakeholders has expanded considerably. Each of these stakeholders has his/her own agenda and complex trade-offs are needed to deal with them. Holding the ring with this mêlée of concerns is one of the dynamics of corporate governance.

1.22 Some Evidence of the Effect of Corporate Governance in Improving Business Results

Effective corporate governance involves the avoidance of doubtful practices which may enhance short-term profits at the expense of reputation which builds long-term profits. Recent concern about the possibility of corrupt payments by BAE Systems to win defence contracts, and continuing anti-monopoly pressures from the EU Commission on Microsoft, demonstrate that corporate governance is not yet fully embedded in business practice. A recent survey by CIMA, the accounting body, which had 1,300 respondents worldwide among members, shows that ethics is high on the business agenda, but that there is a lack of evidence of practical impact.

One important dimension of the impact on profitability of corporate governance is the effect of privatisation, and the governance changes resulting from it, on company performance. A worldwide study by D’Souza, Megginson and Nash in 2005 covers 162 firms privatised between 1961 and 1999. Its results suggest that ‘both restructuring and changes in corporate governance are important determinants of post-privatisation performance. The multi-national, multi-industry sample provides a broad perspective of share issue privatisations and offers opportunities to identify potential sources of efficiency improvements in new privatised firms’.

Measuring the impact of corporate governance on profitability is not simple. Profits change for a multitude of reasons; there is little correlation between high current profits in oil companies and their governance. Another difficulty is the ability of managers to manipulate profits, as at HIM, One.Tel and at Harris Scaife in Australia. This so-called ‘earnings management’ has been driven by reward systems; there is evidence that the separation of the roles of chairman and CEO helps constrain earnings management. There is some evidence that poor governance reduces profits, as was shown in a report from ABI in February 2008 (ABI 2008). This was typified by the example of Northern Rock, which had an unsustainable business model and paid excessive bonuses over four years. The report found that companies with the best corporate governance records produced returns 18 per cent higher than those with poor governance over a four-year period. The analysis covers 241 companies.

On a global scale, there is evidence from an IMF Working Paper (WP/06/293) that corporate governance quality has improved in most countries between 1994 and 2003, based on a CGQ Index devised by de Nicolo, Laeven and Ueda. This index of corporate governance quality has three elements, accounting standards, earnings smoothing and stock price synchronicity. Earnings smoothing is the degree to which managements can manipulate true earnings, while stock price synchronicity reflects the speed of impact of shocks on stock prices (high synchronicity signals poor governance and financial systems). The CGQ Index tracks actual outcomes of governance in the marketplace. It shows the positive effect of good governance on the availability of external finance as well as on growth and productivity.

The relationship between effective governance and profits is difficult to quantify. McKinsey has done three surveys in 1999 and 2000, which show 80 per cent of investors would pay a premium for shares in a well-governed company. There is clear evidence that good governance can bring distinct competitive advantage. Evidence of profit improvement following the implementation of better corporate governance is usually found on a single company basis, not as a clear pattern for groups of companies.

An exception to this approach is the ‘focus list’ issued by CalPERS. This measures the overall performance of companies on the list, which started in 1994 and is regularly updated. In the five years after listing, companies in the 1994 update improved their financial performance by 23 per cent. The 2001 update showed a 14 per cent improvement, and in 2004 only 8 per cent. This seems to imply diminishing returns over time, as the easy benefits are achieved early and further gains are less substantial. Hermes has a ‘shareholder engagement’ approach to performance improvement, in which companies with potential are selected for the Hermes Focus Fund and there is close engagement between Hermes’ team and company directors to overcome underperformance. Hermes’ original
UK Focus Fund has outperformed the FTSE All Share Total Return Index by 4.5 per cent on an annualised basis since its inception in 1998. Similarly, the European Fund has outperformed its benchmark by 1.9 per cent on an annualised basis, while its US Fund outperformed its benchmark by 10.1 per cent on an annualised basis since inception. All of these results show a positive correlation between improving governance and enhancing financial returns. They also demonstrate that the process requires time to produce sustained improvement.

In the case of single companies, it is not always easy to attribute improved profits to any single cause. The recovery of Marks and Spencer was partly due to a new management style and greater openness of reporting. The contributions of George Davis and new fashion, together with improved economic sentiment, have also to be weighed in the balance. In the case of Tesco, profits have been driven by punctilious attention to detail supported by intelligent marketing and Terry Leahy’s global ambition. It started with balanced teamwork and Terry Leahy’s well-timed retirement should reinforce this collegiate approach. A survey in 2004 by ACCA, the accounting body, found that only 12 per cent of respondents believed that corporate governance influenced profitability (only 2 per cent felt that it had significant effect). Most of the positive response came from FTSE 100 companies, i.e., those needing to report in most detail. This seems to indicate that corporate governance is seen as a means of influencing investors in the short-term, rather than building long-term profitability. Such a response underlines the prevalence of the ‘box ticking’ mentality and a lack of understanding of the potential benefits of embedding corporate governance for the long term. Without the prospect of those benefits, institutional investors are unlikely to maintain support for such companies and will invest in winners rather than ‘box tickers’.
Summary

- At the heart of corporate governance is the tension between individual ambitions and the aspirations of society.
- Corporate governance has many definitions; depending on the scope it is granted.
- Corporate governance should not be used as a vehicle for advancing social justice or any purposes which conflict with its key purpose of wealth creation.
- Unless and until it becomes self-sustaining, corporate governance needs to be impelled and shaped by a number of ‘drivers’.
- With the retreat of socialism, there has been a growing acceptance that rewards may be unequal and that outstanding contributors deserve outstanding rewards.
- Monopolies are rarely models for corporate governance.
- External challenge is healthy for all organisations, forcing them to reappraise their performance and adopt better practices.
- Competition itself is driven by change and needs constantly to adapt to new realities.
- Referring to the media as the ‘fourth estate of the realm’ recognises their pervasive power in society.
- The original Code of Best Practice of December 1992 was derived from the Cadbury Report, issued as a draft earlier that year.
- One key feature of corporate governance in the UK and some Commonwealth countries is a reliance on principles rather than rules.
- The Cadbury and other committees which completed earlier inquiries into corporate governance were conscious that their work was exploratory and not definitive.
- Corporate social responsibility also links with the growth of shareholder activism.
- Remuneration concerns have been identified earlier as a key issue for corporate governance.
- Risk and reward are two sides of the same coin.
- Insider dealing is as old as commerce and undermines the concept of fair trading.

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Recommended Reading

Self Assessment

1. Which of the following is the system by which companies are directed and controlled?
   a. Corporate governance
   b. Communal activity
   c. Committee report
   d. The shareholders

2. The ______________ now recognises stakeholders and their relationship with companies.
   a. UK Companies Act 2008
   b. UK Companies Act 2006
   c. UK Companies Act 2007
   d. UK Companies Act 2005

3. Match the following

<table>
<thead>
<tr>
<th>1. Selflessness</th>
<th>A. Avoiding obligations to third parties</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Integrity</td>
<td>B. Acting solely in the public interest</td>
</tr>
<tr>
<td>3. Objectivity</td>
<td>C. Explaining actions fully, restricting information only to protect the public interest</td>
</tr>
<tr>
<td>4. Openness</td>
<td>D. Making judgements solely on merit</td>
</tr>
</tbody>
</table>

   a. 1-A, 2-B, 3-C, 4-D
   b. 1-C, 2-D, 3-A, 4-B
   c. 1-B, 2-A, 3-D, 4-C
   d. 1-D, 2-C, 3-B, 4-A

4. Corporate governance should not be used as a vehicle for advancing social justice or any purposes which conflict with its key purpose of ________creation.
   a. risk
   b. wealth
   c. rules
   d. regulations

5. Which of the following statement is true?
   a. The public is suspicious of ‘short poppies’ and is usually pleased to see them cut down to size.
   b. The public is suspicious of ‘more poppies’ and is usually pleased to see them cut down to size.
   c. The public is suspicious of ‘few poppies’ and is usually pleased to see them cut down to size.
   d. The public is suspicious of ‘tall poppies’ and is usually pleased to see them cut down to size.

6. What are rarely models for corporate governance?
   a. Competition
   b. Monopolies
   c. Companies
   d. Governance
7. ________ challenge is healthy for all organisations, forcing them to reappraise their performance and adopt better practices.
   a. Internal
   b. Company
   c. External
   d. Important

8. Which of the following statement is false?
   a. The media are also a stakeholder in most organisations, rarely at the wish of management but as ineluctable as HMRC.
   b. The media are always passive and pursue an agenda largely of self-interest.
   c. The media are drivers of corporate governance through revealing hidden misfeasance, not by stimulating best practice.
   d. The media do not always have a free hand in dealing with companies.

9. Principle-driven ________ encourages the best companies to go beyond compliance with the Code to demonstrate better practice and build trust.
   a. reporting
   b. practices
   c. data
   d. rules

10. Recognition of the role of stakeholders was advanced by the ‘Tomorrow’s Company’ Inquiry, led by the Royal Society of Arts (RSA) and published in ______.
    a. 1994
    b. 1991
    c. 1992
    d. 1995
Chapter II
The Global Pattern of Corporate Governance- Different Approaches and Cultures; Winners and Losers

Aim

The aim of this chapter is to:

- introduce the global pattern of corporate governance
- explain the common law based countries
- explicate shareholders and stakeholders

Objectives

The objectives of this chapter are to:

- explicate predominantly two-tier countries
- elucidate the other countries
- explain the gulf co-operation council (GCC)

Learning outcome

At the end of this chapter, you will be able to:

- identify extraterritorial abuses of US law
- understand the 2006 Banking Code
- recognise key areas for action identified in the White Paper
2.1 Introduction

There is no unanimity of purpose or structures in corporate governance. This variance in approach is due to differences in legal structures and cultural influences and is compounded by political and other power structures. Some proponents of corporate governance see it as a means of making business more socially responsible; at the other extreme are individuals who see it as an instrument of personal control. In between, there is a range of advocates whose agenda is more in line with the OECD definition of 1999, i.e., to make the company work more effectively and responsibly.

Although the earlier models of corporate governance emerged in the USA and UK, the concerns which created them are shared by most countries with private ownership systems, and most of these countries have now developed their own laws and/or codes to improve and regulate corporate governance. This chapter will review these and seek to draw out indicators of better practice for all countries to consider adopting.

In considering the global pattern of corporate governance, it is helpful to segment the world into distinct groupings. These reflect not only geography, but legal and cultural differences which impact on commerce. Another key difference is funding; the USA and some Commonwealth countries are largely stock market funded; many others rely on bank, family, state and other sources of funding. The former are known as ‘outsider’ systems, the latter as ‘insider’ systems. Such groupings are as follows:

- Common Law based countries (USA, UK, Commonwealth) – Outsider systems
- Roman/Napoleonic Law countries – Insider systems
- Sharia Law countries (Saudi Arabia, Gulf States, Indonesia, etc.) – Insider systems
- Far East (China, East Asia, Japan, etc.) – Insider systems
- Russia and parts of former Soviet bloc – Insider systems

Using these broad groupings, it is possible to segment further and begin to draw out comparisons, starting with Common Law based countries:

2.2 Common Law Based Countries

Common law based countries are discussed below.

2.2.1 USA

Professor Kaplan of Chicago Business School sees Henry Kravis of KKR, and other corporate raiders of the 1980s, as the architects of today’s corporate governance in the USA. Before 1980, US companies focused on sales, earnings growth and whether executives were paid well, but not excessively. Corporate raiders and leveraged buyout (LBO) specialists used debt to buy companies and drove up performance to enrich themselves. Corporate executives were quick to learn this new game and have increased their own earning capacity, largely through bonuses, shares and share options. With higher gearing, companies needed to be monitored more closely and driven more aggressively to service loans and satisfy both institutional shareholders and executives. Once their process had been learned, LBOs became unnecessary, as executives could drive the businesses themselves and exploit insider knowledge. Ironically, a new wave of LBOs has emerged in the form of private equity and hedge funds. This may be an oblique tribute to the development of corporate governance in the USA, since private equity and hedge funds are largely unregulated and can operate with minimal publicity.

The inheritance of the LBO era and of the growth of demanding institutional shareholdings was a rash of scandals around the turn of the century, Adelphi, Enron, Tyco, WorldCom and others, which showed fundamental flaws in the US corporate governance, in the federal regulator, The Securities and Exchange Commission (SEC), and the operation of many state legislatures. According to Jay W Lorsh of Harvard Business School before the scandals, action was already in hand through public investors, with the support of corporate governance activists, such as Robert Monks, Nell Minnow and Ira Millstein, to increase pressure on corporate boards to be more effective. Improvements in corporate governance were swamped by the Millennium rush to self-enrichment, leading to the scandals mentioned above and the precipitate passing of the Sarbanes-Oxley Act 2002 (SOX) and new stock exchange listing requirements.
Sarbanes-Oxley prescribes board arrangements which include separation of the roles of CEO and chairman of the board, a majority of independent directors (with greater powers), three core committees (Audit, Compensation and Corporate Governance) and stricter evaluation of the CEO, who (with the CFO) is now required to certify that the accounts accurately reflect the company’s financial condition. False statements are treated as a criminal act. Section 404 of the Act requires managers to review and certify the adequacy of financial controls, causing great expense and diversion of management time. The Act places the Audit Committee in control of internal audit and all links with the external auditor; audit committees are composed solely of independent directors, at least one of whom must be a ‘financial expert’. The Sarbanes-Oxley approach to board management is reflected in part in the UK Higgs and Smith Reports.

Sarbanes-Oxley has galvanised US corporate governance, but its costs are high and have hurt smaller companies. One result has been a migration of smaller companies to overseas countries, where regulation is less burdensome. Sarbanes-Oxley does not address the key question of shareholders’ rights to nominate directors and to participate in governance. Despite some well-publicised activity by activists such as Carl Icahn, and some hedge funds, most US investors act like punters rather than owners. Institutions like CalPERS, which take a long-term view of their investments, remain very much the exception in the US investment community.

Looking ahead there are at least three significant challenges to be met in US corporate governance. These are as follows:

- To bring shareholders and other stakeholders into the governance process.
- To avoid the concentration of power towards the CEO.
- To contain any extraterritorial abuses of US law.

**Shareholders and stakeholders**

Institutional shareholders now own the vast majority of US company shares and are gradually winning new powers, e.g., relaxed proxy rules for shareholder communications. Even more significant is the SEC requirement that companies provide more detailed information about top executive remuneration and its relationship to company performance. Shareholders still lack rights over the choice of directors and this may be more problematic as company boards become more influential in directing US companies, in contrast to the traditional power of American managers. Shareholders have little right of access to the governance of US companies at present, other than under non-corporate legislation. The growth of social and environmental pressures seems likely to have a growing impact, as it has in other OECD countries. Employees are already covered by employment legislation.

**Power and the CEO**

As US companies have primarily been run by executive committees rather than the board, power has been largely concentrated in those committees, and in particular, their leader, the CEO. Where the CEO is also on the company board, his/her pivotal position has enhanced this power. The LBO movement increased the power of executives, since they know how to harness the real potential of the company, using borrowed money and gearing up executive rewards. After the Second World War, CEO-remuneration was formerly some 20 times that of shop floor workers but has now risen to 300/400 times or more. The Sarbanes-Oxley Act and increasing interest from shareholders to avoid being held to ransom by greedy CEOs are combining to dilute CEO power and make CEOs more accountable. The move to split the roles of chairman and CEO received a setback at ExxonMobil in 2008, but seems likely to win support not least as a result of the excesses which fuelled the banking crisis.

**Extraterritorial abuses of US law**

International law has laid down clear principles to allow the exercise of jurisdiction. These involve territory, nationality, passive personality (exceptionally), security and universality. Most countries follow these principles scrupulously; the USA is the main exception, advocating extraterritoriality because of globalisation and practising it, e.g., extraordinary rendition of terror suspects. There is some concern that laws like Sarbanes-Oxley, which can put US companies operating onshore at a disadvantage compared with those operating overseas, may be used extraterritorially. The USA has been active in attacking offshore registration regimes, under the pretext of preventing money laundering for terrorists. At present, the Saudi Arabia ‘Aramco Rule’ seems to block extraterritorial use of
corporate governance legislation, but Sarbanes-Oxley has already proved to be anti-competitive for US corporations and pressures to redress its effects are likely to increase. Recent criticisms of the ‘soft’ regime of the Financial Services Authority (FSA) in the UK are driven by loss of registrations of companies in New York and underline the US instinct to impose their regulatory thinking on other countries. Adoption of International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board, may be a rare exception or possibly the beginning of a new trend.

2.2.2 UK

The UK regime is well respected internationally, both as a pioneer and model, and as an approach to governance which is pragmatic and not excessively bureaucratic or expensive. Both the US and UK regimes have been criticised for failure to anticipate and prevent the recent financial crisis. Nevertheless they remain a source of innovation in corporate governance and a stimulus for better practice.

2.2.3 Canada

The foundations for corporate governance in Canada were laid in the Dey Committee Report of 1994. This was supported by Guidelines issued by the Toronto Stock Exchange in the same year. This foundation was developed in 2001 with the publication of ‘Beyond Compliance: Building a Governance Future’ by the Canadian Institute of Chartered Accountants. The main influence on Canadian corporate governance is the closeness and weight of the US economy. Inter-listed companies comprise 60 per cent of Canada’s total market capitalisation; the other 40 per cent is mainly numerous smaller Canadian companies. This pattern imposes US models of governance on Canada, although their introduction is often piecemeal. Much of Sarbanes-Oxley is now operative in Canada, in particular the personal certification of the accuracy of financial reporting by the CEO and CFO. From 2006 to 2009, there was the progressive introduction of the Internal Control Rule SOXs S.404 which will increase bureaucracy and cost. For inter-listed companies, however, the marginal cost in Canada is not high. The focus of capital market reform in Canada is on the following:

• Financial reporting (auditor oversight, audit committees and CEO/CFO certification).
• Full disclosure of governance action, in particular of the board’s oversight of management.
• Civil liability legislation on directors’ accountability and liability.

Given the fragmented regulatory infrastructure in Canada, and smaller size of its market, Canada will have increasing difficulty in keeping up with the pace of reforms driven from the USA. Canada only has 2 per cent of world market capitalisation.

2.2.4 Australia

Australian capitalism has developed out of a ‘frontier spirit’ epitomised by ‘cowboys’ like Alan Bond, into larger scale and maturity. It was earlier an ‘insider’ system, based on ‘clubby’ relationships and mutual directorships, but as Australian companies outgrew their market, some moved aggressively overseas, e.g., News Corporation, Broken Hill, AMP and more recently Macquarie. The internationalisation of key Australian companies has left many of them with ‘block-holders’ (earlier family and core shareholders) and growing institutional holdings. An example of this phenomenon is Coles Myer, the largest retailer in Australia, where institutional attempts to control self-seeking actions by one key block-holder had only limited success, despite interventions between 1995 and 2002. In 2004, activists succeeded in blocking an executive share option scheme sponsored by Rupert Murdoch at News Corporation, but this led to the transfer of News Corporation’s registration to the USA at the end of that year.

Brian Cheffins has suggested that the Australian system is evolving into an ‘outsider’ one, due to the growth of the Australian stock market and institutional investment in it. A company, such as BHP Billiton would be a harbinger of this change. BHP was founded in 1885, as Broken Hill Proprietary Company and grew steadily within Australia until the 1960s. It then diversified overseas and in 2001 merged with Billiton, founded in the Netherlands in 1860, and developed by Shell. BHP Billiton is the world’s largest primary resource company, quoted in London, New York and Johannesburg. In 2007 it launched a bid for Rio Tinto, its close rival, moving the company even further into an ‘outsider’ investment, at a time when institutional investors from Asia have been joining the rush for Australian assets.
Australia’s corporate governance was modelled on Cadbury, and Australia has two codes, the Bold Report of 1995 created one, the other was developed by the Investment and Financial Services Association. As Australia recovers its poise following earlier scandals, HIH Insurance, One.Tel, AMP, etc., it seeks to develop its own pattern of governance. The Australian Chamber of Commerce and Industry has reacted to the potential impact in Australia of SOX and the US tendency to seek extra territoriality of its legislation. Australia takes its own line in the world of corporate governance.

2.2.5 New Zealand

New Zealand's economy has been built largely on smaller companies, with a strong bias towards exporting. In a small country, business leaders know each other well, and ‘clubby’ relationships develop. Corporate governance is an import into New Zealand, based on UK and US models and seen as necessary to encourage outside investment. In 2004 the Securities Commission of New Zealand issued ‘Corporate Governance in New Zealand, Principles and Guidelines’. This built on the 1993 Companies Act and Financial Reporting Act to offer practical guidance and encourage the use of independent directors. Hossain, Prevost and Rao (2001) had earlier criticised the impact of the Act. A 2003 paper from the law firm Chapman Tripp was also critical of the New Zealand Stock Exchange rules were seen as too non-specific for US investors and unhelpful in bridging a governance gap with Australia, where the ASX Guidelines were more principles-based ‘If not, why not’? In 2003 the New Zealand recommendations included most of the SOX rules, slightly modified, one third of all directors to be independent, separate chairman and CEO, certified qualification for all directors, an audit committee with a majority of independent directors (one with an accounting qualification), auditors rotating the lead partner every five years, etc.,. Research over the period 2001- 5 into 71 ‘small cap’ New Zealand companies, undertaken by Reddy, Locke, Scringeour and Gunasekara (2008), shows that board and audit committee independence had enhanced financial performance as measured by Tobins Q. This measures the premium value of assets over their replacement cost.

2.2.6 South Africa

Apartheid collapsed in 1994, reopening the South African market to international investment. Before 1994, much of the work of governance was stimulated by the South African Chapter of the Institute of Directors (IOD), founded in 1960 by Harry Oppenheimer. The 1994 King Report was sponsored by the IOD, and stimulated interest in corporate governance, leading to the definitive King Report of 2002. This is based on UK codes then current. A 2002, Deutsche Bank analysis of 73 South African companies demonstrated the value of the King approach to corporate governance even before his code became mandatory.

A number of South African companies have moved their company registration overseas since 1994. These include South African Breweries, Old Mutual and Anglo-American Corporation. The rationale for the move is to have access to larger pools of capital. As it moved in 1999, South African Breweries has bought Miller Brewing in the USA and now trades as SAB Miller. Both Anglo-American and Old Mutual have considerably expanded their activities since moving from South African domicile. In recent years, the ‘black empowerment’ agenda of the government, acting partly through the Public Investment Commissioners, has steadily increased the number of black directors, both in public and private companies. These are expected to be change agents, turning the profile of their companies to reflect the race and gender profile of South Africa as a whole. To date their impact has been limited politically, and their effectiveness is mixed.

2.2.7 Ireland

Company law and corporate governance in Ireland have broadly followed models from the USA and the UK in the past. Following a series of political and tax scandals in the 1990s, an Office of Corporate Enforcement was established as prescribed in the Company Law Enforcement Act 2001. The Act sought to improve supervision of some 13 Companies Acts and various statutory instruments which remained in force. In 2002, the Company Law Review Group recommended a statutory definition of directors’ duties, and, following the O’Toole Report of 2000 on audit, new auditing legislation was proposed. The proposed new legislation included the requirement for a compliance statement from directors in respect of all statutory obligations. The Act became law in 2003, in the wake of SOX, which gave impetus to further strengthening of company law.
A new Companies Bill provides for the consolidation of all earlier legislation and gives greater clarity to practitioners. It also simplifies earlier aspects of company law since 90 per cent of Irish companies are registered as private companies; a constitution replaces Memorandum and Articles, AGMs may be waived, a single director is legal and no ‘objects clause’ is needed (removing ultra vires risk). Winding up is also to be simplified. The role of corporate governance in Ireland’s recent financial crisis remains to be clarified.

2.2.8 Spain
Franco created a state-owned industrial structure, similar to that of Mussolini, which has been slowly dismantled and largely privatised to a large extent. Foreign share ownership is now 24 per cent compared with only 14 per cent in Italy and a European average of 36 per cent. This has helped to open up Spain’s economy and corporate governance, which is now a hybrid model, influenced towards the Anglo-Saxon approach through the Olivencia Commission Report of 1998 and the Aldama Report of 2003. These are consolidated and reinforced in the CNMV Unified Code of 2006.

Heidrick and Struggles (2005), which monitors progress across Europe, notes ‘wideranging improvement in the implementation of good corporate governance in Spain … There remains a conspicuous need for standardisation and governance legislation’. A key weakness is the preponderance of executive and ‘reference shareholder’ directors on Spanish boards, so that only 39 per cent of directors are independent. Reference shareholder directors are placed by companies with a strategic shareholding in the firm. In 57 per cent of companies, chairmen are not independent and in only 11 per cent of companies are audit committees composed solely of independent directors (14 per cent for remuneration committees). In 11 per cent of companies, there are no independent directors on the Remuneration Committee. Average board tenure is longer than elsewhere in Europe and only 2.6 per cent of directors are women, which reflects the rigidity of many board structures.

The new Stock Market (CNMV) Unified Code of 2006 addresses some of the problems above. Greater emphasis is laid on a strict definition of ‘independent’ directors. They should not have business dealings with the company nor ‘affectionate relationship’ with other directors or officers of the company. One third at least of the board should be independent. According to Foretica, a business membership organisation, greater transparency is needed, with a clear separation between ownership and management (the ‘reference shareholder’ directors to go?). Acquisitions by Spanish companies in the UK (Santander, Telefonica, Ferrovial, etc.) will increase pressure for improved corporate governance in Spain.

2.3 Roman/Napoleonic Law Countries
These countries may be segmented into those with two-tier board structures and those with single boards, since the internal dynamics differ between each model. Countries with two-tier boards usually have simpler structures for smaller companies. Their two-tier board model may be subdivided into pure two-tier boards (with no overlap), typically German and some French, and mixed two-tier boards (with executives on the supervisory board). These are usual in Belgium, Italy, Portugal, most of France, Sweden and Switzerland.

2.4 Two-tier Countries
The two-tier countries are discussed below.

2.4.1 Germany
Post-war German economic development has been based on co-determination (Mitbestimmung), which involves a partnership between shareholders, management, employees, trades unions and banks. In large companies, there is a legally obligatory supervisory board (Aufsichtsrat), comprising representatives of shareholders, trades unions (employees) and banks. Up to 50 per cent of board places in large companies have employee representatives (trades unions). Such companies have a management board (Vorstand) comprising solely managers. Germany has only 20 per cent of the number of quoted companies that the UK has; most German firms are limited partnerships (Gesellschaft mit beschränkter Haftung or GmbH) with a manager (Geschäftsführer) and executive team. Firms with more than 50 employees must have a works council, with employee representation. Most of these firms are privately controlled and conservatively managed, known as the ‘Mittelstand’, they are the core of German industry.
The German ‘stakeholder’ model has no direct equivalent elsewhere and has been very successful until recently. It has been underpinned by controlling shareholders or large share blocks, with cross-holdings and pyramid holdings to control competition, so that the marketplace has been stable. The growth of institutional investors and decline in family companies has weakened cross-holdings (including by banks), weighted shares and other control mechanisms. Employers are impatient of union participation (many supervisory boards meet rarely) and internationalisation is loosening German structures. Unions are weaker but fighting back.

A German corporate governance code (Deutscher Corporate Governance Kodex) was published in 2002 (and updated last in 2007). It applies to listed companies and underpins the dual board system, and the role of the supervisory board in appointing and supervising the management board. Adherence to the code, where applicable, is recommended for non-listed companies.

The Code assures that each share carries one vote, and it supports pre-emptive rights for new issues. Strategy is shaped by the management board and approved by the supervisory board. The latter establishes an audit committee, a nomination committee and a committee to handle contracts with management members. These committees must comprise directors who are independent and have specialist knowledge. The members of the Nomination Committee are exclusively shareholder representatives. The Code is otherwise not dissimilar to the OECD and other relevant codes. It adopts a ‘comply or explain’ approach which is new to Germany. It does not reflect the impact of SOX but represents a move to greater openness and equal treatment among shareholders. One innovation is the option for transnational companies to operate as a Societas Europea (SE), having a single-tier board and more flexible regulations. SE regulations were established by the EU in 2004 in order to further cross-border mergers and offer a way, in some circumstances, to dilute German labour representation on the board. A similar European model for private companies is being developed.

There is a battle between block shareholders seeking to perpetuate ‘self dealing’ privileges and international investors seeking to open the German system to more accountable and flexible working. It will be a long time before Germany has an ‘outsider’ system but the trend is in that direction.

2.4.2 France

Traditionally, many key industries in France have been controlled by the state. In recent years some state companies, e.g., EDF, have been partially privatised, but the government continues to exercise influence on ‘the commanding heights of the economy’. This influence extends to private companies; in 2007 a merger between Gaz de France and Suez was used to pre-empt foreign intervention. French capitalism does not operate in a totally free marketplace.

The French capital market has also been built on cross-holdings of shares, creating an inter-related network of directorships. This significantly reduces the free shares in circulation and underpins the status quo in the marketplace. These practices were attacked in the Viénot Report on corporate governance in 1995, and in the 2003 MEDEF Code. Also under attack are variable-weighted voting rights, anti-takeover devices and limits on pre-emption rights. A Hermes report in 2007 lends support to the MEDEF Code, which remains largely unimplemented, since shareholder activism in France is underdeveloped, despite heroic efforts from Association de Defense des Actionnaires Minoritaires (ADAM), a small shareholder lobby led by Colette Neuville, and a few enthusiasts. Some big companies, including St Gobain and Carrefour, have recently elected shareholder directors, and investment funds are becoming more demanding. A recent battle at Atos Origin, a computer services firm, enabled Pardus Capital and Centaurus Capital, two London-based hedge funds, to win board seats and oust the chairman.

Progress is monitored biennially by Heidrick and Struggles across Europe. Its 2005 study shows overall progress in France, but only 20 per cent of audit committees are entirely composed of independent non-executive directors (in the case of remuneration committees only 18 per cent). Twenty five per cent of companies in the CAC40 index still have no independent directors on board committees. Although 45 per cent of French directors are stated to be independent, there is some doubt about the definition of ‘independent’. Turnover of directors is below average, while age and tenure are above average. Only 7 per cent of French directors are women.
Despite its underlying chauvinism, French business has been reasonably successful in expanding overseas, e.g., AXA. This is largely because it usually imposes a French model on its overseas outlets. As with Alcatel-Lucent, where cultures cannot be reconciled, the result can be failure. As the state gradually reduces its holding in key companies, and Brussels blocks state subsidies, e.g., Air France and SNCF, it is likely that French capitalism will become more shareholder-orientated. Michel Goyer, in a MIT thesis in 2004, sees French managers asserting power to concentrate and expand their companies while German managers remain concerned to deal with workforce power. In France, the battle for supremacy between shareholders and well-entrenched managers has only just begun, however.

2.4.3 Italy

The rise and fall of Venice as a trading nation reflects the early history of Italian enterprise. Napoleon destroyed Italy’s early advantage and, despite its entrepreneurial vigour, it has lagged behind the new world powers in economic terms. Mussolini sought to strengthen Italy’s economy by creating state monopolies in key sectors, power, chemicals, etc., in order to compete with other economies. Most of these companies have been privatised, e.g., ENEL (power), and have joined private groups, such as Fiat and Generali, on the Milan Stock Exchange. The cutting edge of Italian enterprise continues to be the plethora of smaller companies often grouped by industry in one place, e.g., furniture in Alto Livenza, and operating worldwide. Many of these companies are family-owned; most have tightly controlled share structures.

In 1998, the Draghi Commission recommended reforms to bring Italian corporate governance closer in line with OECD guidelines. These included discouraging pyramid and cross-shareholding structures, strengthening minority shareholder rights and enabling shareholders to appoint a member of the statutory audit board. According to Heidrick and Struggles (2005), Italy has the lowest corporate governance rating in Europe. At that time Parmalat had just collapsed and it did not have the worst corporate governance rating among Italian companies. Although 47 per cent of directors are classified as ‘independent’, 90 per cent of Italian companies are family-owned, so that the meaning of ‘independence’ is unclear. Some 10 per cent of Italian companies do not have board committees and only 40 per cent of companies have committees composed solely of independent directors.

Italy’s corporate governance is not strengthened when Cesare Geronzi seeks to abolish the supervisory board of Mediobanca, which the Bank of Italy required in order to control the insistent meddling of Mediobanca in companies it ‘advised’. Geronzi is supposed to have manipulated the sale of Capitalia to Unicredit earlier, a move typical of Mediobanca influence over the years. Improvements in Italian corporate governance can only come when international investors can invest in Italian companies with confidence. Corruption is the biggest threat to effective governance in Italy and the present government has weakened attempts to deal with it. Italy has fortieth place in Transparency International’s global ranking, the lowest in Europe apart from Greece.

2.4.4 The Netherlands

The foundations of Dutch corporate governance were laid in the Tabaksblat Code of 2003, which strengthened the earlier and largely voluntary, Peters Code of 1997. The model for larger Dutch companies comprises a two-tier board, with arrangements similar to those in Germany, but with fewer employee representatives. This reduction came about in 2004 as a result of concern about over-representation of Dutch workers in multinational groups. Two-tier boards are becoming exceptional for large multinationals in any case; Royal Dutch Shell is the most recent convert to a unitary board (2006).

Heidrick and Struggles (2005) ranks the Netherlands as third best performing country in corporate governance, after the UK and Switzerland. Of 25 companies in the AEX Index, five had dual-nationality (four Anglo-Dutch, one Belgo-Dutch). Corus has been bought by Tata since 2005. Some 68 per cent of shares in these companies are owned by non-nationals, and their operations are largely overseas.

Dutch directors come from a small circle and relationships are close. Greater emphasis is needed on selecting and evaluating independent directors. The frequency of board committee meetings is below the European average, which weakens the scope for independent influence. Dutch boards have an above average mix of nationalities; female participation is 6.8 per cent (below the European average). Dutch directors have the highest age profile in Europe (61.4 years on average).
In the 2007, Heidrick and Struggles Report there is a significant increase in foreign non-executive directors, to the point where 36 per cent of all directors are non-nationals. Another improvement is greater emphasis on committee work. Dutch companies increasingly have ethics, corporate governance and CSR committees (22 per cent of Dutch companies overlap a CSR committee). This picture is not replicated in smaller Dutch companies, which tend to be narrower in outlook and less open in their operation, but better practice is beginning to filter down

2.4.5 Switzerland

Switzerland has traditionally relied on self-regulation and has tended to favour its own citizens. Many Swiss companies are run as ‘close’ companies and multiple classes of shares have enabled minorities to be largely ignored. The 2002 corporate governance code is comprehensive but was voluntary until reinforced by legislation in 2005. The failure of Swissair and SBG, and the ADR trading of Novartis, UBS and others, have forced Swiss regulators to remodel corporate governance nearer to international norms. Reforms of company and insurance supervisory law in 2005 were also driven by SOX and the EU Eighth Directive. At the same time audit supervision standards were aligned with US and other demanding norms. Further reforms to help Switzerland to converge with international corporate governance standards are expected, including the following:

- Lower thresholds for the exercise of certain shareholder rights.
- Revision of proxy voting rights.
- More flexible procedures for changes in share capital.
- Use of electronic tools for AGMs.
- Revision of accounting and reporting legislation. (Source: Markus Schweizer, Ernst & Young 2005).

The 2007 Heidrick and Struggles Report emphasises the progress made by Swiss companies, but points out the large gap between best and worst performance. The latter are mainly small national firms which remain unwilling to adopt parts of the 2002 Code. Such companies have small unitary boards, meet infrequently and pay higher directors’ fees than in equivalent companies elsewhere in Europe. Overall, Swiss companies continue to perform poorly in evaluating their boards; by 2005 only 20 per cent had yet undertaken a board review. Their performance with board committees is below average; ethics and CSR committees are rare.

Switzerland has a high proportion of non-Swiss directors (45 per cent) and this group is likely to include a wider range of countries (currently they are mainly US and German). It is to be hoped that these independent directors will add to the pressure for Swiss corporate governance to match best practice. A recent change in regulations has been made to increase the capital of banks to preclude any new banking crisis.

2.4.6 Sweden

Sweden resembles the Netherlands in having a significant number of multinational companies, and Italy in having a few integrated mega-groups, e.g., Investor A.B. (owned by the Wallenberg family). Investor invests in, and effectively controls, a number of Swedish companies, e.g., Electrolux and Saab. Investor was built up over many years, using weighted shares to assert control even with a minority holding, and placing directors in key companies to protect its interests (like Spanish reference shareholders). Sweden only published a corporate governance code in 2005; it is voluntary and overseen by an independent business board.

One effect of the codes has been to encourage compliance and avoid the long tail of outliers seen in Switzerland. Another strong point is the requirement for annual board evaluations, unique in Europe. Evaluations are not, however, uniformly transparent yet. Sweden’s committee performance matches European practice, and Sweden has separate remuneration and nomination committees, not yet controlled by independent directors, as in the UK. Sweden has 21 per cent female directors and leads Europe in gender diversity. Sweden has only 16 per cent non-national directors, though from various countries. Some 30 per cent of Swedish boards have no non-national director (largely because only Swedish is spoken in most companies).
According to Anders Bäckman of Magnusson Law Firm, the Swedish government is proposing legislation to increase transparency and shareholder influence over remuneration. The first corporate governance reports under the Code were introduced for the 2005 financial year. After a cautious start, these are beginning to have some substance. The Internal Control Report uses the framework required by Turnbull in the UK. Again after a hesitant start this process is bedding down. The new 2006 Companies Act is more comprehensive than its predecessor, and consolidates many of the changes made by the 2005 Code. The new Act increases accessibility to general meetings, including the option for electronic media. Legislation is proposed to regulate and publish directors’ remuneration and have it approved at the AGM. Although a late starter, Sweden is coming steadily into line with European best practice.

2.5 Other Countries

The other countries are discussed below.

2.5.1 Turkey

The OECD Principles of Corporate Governance are a global standard by which Turkish practice may be measured. In an address in 2006 to the Capital Markets Board of Turkey, Angel Guria, OECD Secretary-General, commented on a report by OECD measuring progress. He found that Turkey has a strong regulatory framework for corporate governance and that international accounting standards are being introduced, though amendments to company law are needed to complete the change.

Turkish companies are often subject to controlling shareholder pressures, even when listed on the Istanbul Stock Exchange, and minority shareholders are not well protected. Improving supervision from the Capital Markets Board (CMB) may reduce investors’ concerns. Greater openness is needed in respect of related party deals, and institutional investors need greater access to participation in company governance. More accountability is needed on the working of company boards, using the OECD Principles as a guideline. Greater involvement is needed by the CMB in ensuring that companies operate with integrity and prudence. The CMB needs better funding to carry out its regulatory duties more thoroughly. Turkey needs to practise high standards of corporate governance, if its economy is to benefit from increasing international investment.

2.5.2 Israel

Israel’s company law was based on the UK law, reflected in the Companies Ordinance of 1929, and updated as a new Corporate Code in 1987. Israel’s economy has had an ‘insider’ pattern for many years, with sole shareholders or groups of shareholders operating under mutual agreement. This pattern has restrained the growth of the Tel Aviv Stock Exchange, with growing Israeli companies tending to seek funding overseas. The Enron scandal and SOX were a shock to the Israeli authorities and a committee was founded under Professor Goshen to prepare a corporate governance code. This was published in 2006 and reflects the main provisions of SOX. At the same time, the Tel Aviv Stock Exchange has achieved Developed Status with London Stock Exchange (LSE), facilitating joint quotations. Israel’s ‘war zone’ situation does not seem to discourage overseas institutional investors, and Israeli companies have strong niches in the pharmaceutical/biochemical and electronics sectors. The Israeli Companies Law has been updated and now focuses heavily on control systems. Israel is the only country which requires public companies to appoint internal auditors.

2.5.3 Russia

State ownership is the model from which Russian capitalism has sought to escape. The Russian Trading System (RTS) Stock Exchange was only established in 1995 and has yet to enter the top world rankings. The breakup of the Soviet Union opened the door to a massive transfer of state assets into the hands of those who managed them; later these assets were partially consolidated into holding companies owned by ‘oligarchs’, while considerable funds were moved offshore to buy foreign assets beyond the reach of the Russian authorities.

President Putin came to power in 1999 and set about redressing the excesses of the Yeltsin presidency. He restored central control of Russia and brought most of the business oligarchs to heel in various ways (not always legal). In 1999, the Russian Corporate Governance Roundtable was established to help bring Russian companies into line with best international practice. A ‘White Paper on Corporate Governance’ was published in 2002, which led to a move to implement IFRS accounting standards and work to improve transparency of related party transactions. This work was supported by the Russian authorities in order to encourage foreign investment.
A series of moves to force the sale of oligarchs’ companies has concentrated power in the hands of groups close to the state, e.g., Gazprom, discouraging foreign investment. Similar pressures have forced out key Russian partners in development projects, e.g., Shell. BP’s investment is now under attack. Russian GDP growth has been spearheaded by oil and gas, with most other sectors uncompetitive internationally. This has led to considerable speculative portfolio investment and less strategic investment. A paper by Igor Belikov (2004) of the Russian Institute of Directors queried how much speculative investors would pay for good corporate governance. It showed investment concentrated in the resources sector (with rapid growth) and only selectively elsewhere. A rating of world energy company corporate governance by Energy Intelligence in 2004 ranked Yukos second to Marathon (with Gazprom nineteenth). Yukos was led by Mikhail Khodorkovsky, an oligarch who was later convicted of tax fraud. The assets of Yukos were auctioned off to Baikalfinancegroup and the company liquidated. Gazprom is believed to have financed the purchase by Baikalfinancegroup.

Actions of the Russian government have cast a shadow over corporate governance in Russia and the work of the Russian Corporate Governance Roundtable continues, but with limited traction. Good governance in Russia is largely sustained by well-entrenched multinationals, such as Unilever.

2.5.4 Japan

Japan’s economy has traditionally been built on large interlocking corporate groups. Before the Second World War these were named ‘zaibatsu’ and had close government support. After 1945, these groups were broken up but have largely reformulated themselves as ‘Keiratsu’. Government has been closely involved in order to create and steer Japan’s postwar economic miracle. Japan remains an ‘insider system’ country, with few significant overseas investors (Renault is a notable exception) and limited shareholder rights. Companies are largely controlled by their managers and boards who meet infrequently.

Now that 25 per cent of shares are foreign-owned there is increasing concern at the opacity of Japanese governance. According to The Economist, Lord Mandelson, the then EU Trade Commissioner, saw Japan as the most closed market for investors in the industrialised world. External takeovers are rare: T Bone Pickens tried earlier and failed, and TCI, a British hedge fund, has been stopped recently from doubling its 9.9 per cent stake in J Power, a big electrical utility. Steel Partners, a US activist investor, has been blocked from acquiring Bull-Dog Sauce by a poison-pill defence. This tactic was upheld by Japan’s Supreme Court.

The situation has caused Hermes and other international investment funds to call for sweeping reforms in corporate governance, according to The Economist. They wish Japanese firms to recruit independent directors, abolish poison-pill defences, cross-share holdings and increase dividends. The Asian Corporate Governance Association (ACGA), representing global investors with funds of some $5 trillion, has reinforced this demand in a major policy paper. This concern is finding support from the Council on Economic and Fiscal Policy, appointed by the Prime Minister of Japan, which is seeking fewer barriers to foreign takeovers, lower corporate taxes and reform of the public pension scheme.

The process of improving corporate governance in Japan has been supported for some years by the Corporate Governance Forum of Japan, which has laid down key Corporate Governance Principles to guide reform. The need for increased external investment in Japanese companies is beginning to have some effect (smaller boards, stronger oversight of operations and more independent directors). Despite some progress there remain significant cultural barriers to reforming corporate governance in Japan, including a sense that Japan is special and that US models have not improved business performance. It is ironical that the popular model of a businessman in Japan is ‘Mr Shima’, a young meritocratic boss, who is featured in a bestselling ‘manga’ or cartoon strip and is fictitious and quite untypical of Japanese business. It remains to be seen whether the 2011 tsunami will help to open Japan to outside investment, but the strength of internal saving makes this less compelling.
2.5.5 China
China famously defines itself as ‘one country-two systems’. China itself is moving from a Communist model towards controlled capitalism; Hong Kong has for long thrived on a liberal capitalist model.

China’s traditional corporate model is the state owned enterprise (SOE). This evolved until, under the Corporate Law 1993, a modern corporate system was established, allowing state owned, closed and public companies to be set up. Under the 1993 Law, companies must have shareholders, a board of directors and a supervisory board. The board of directors must have a chairman and a CEO. This structure is not similar to the German model, since both directors and supervisors are appointed/dismissed by the shareholders. In state-owned companies, directors mainly rank as civil servants and supervisory board members are appointed by the shareholder/government. Such arrangements need further reform.

Closed company structures are used for smaller corporations and were used for foreign companies and joint ventures until China joined the World Trade Organisation (WTO). Foreign companies may now invest in Chinese public companies in principle, and subject to strategic considerations. Concern about earlier company scandals and the risk of losing investment led to the ‘Code of Corporate Governance of Listed Companies’ was being issued by the China Securities Regulatory Commission (CSRC) in 2001. Later that year ‘Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies’ followed. These documents predate the UK Combined Code, but are largely based on US and German models. They do, however, emphasise the rights of minority shareholders and the importance of empowering independent directors, According to Julian Roche in his book Corporate Governance in Asia (2005) the main problem is likely to be the limited resources of the CSRC to regulate over 2,000 listed companies in depth, so that China is still not reliably compliant with rules, let alone the spirit of corporate governance.

2.5.6 Hong Kong
Hong Kong’s legal system is based on a Common Law framework and its stock market is ‘one of the most effectively regulated markets in Asia’, according to Julian Roche. Insider dealing has had less effect in Hong Kong than in most other Asian markets. After 1997 the regimes in China and Hong Kong remained initially distinct. More recent evidence is disturbing; in ‘Disclosure in China; Steppping Backwards’ The Economist (31 May 2008) reported on the resignation from the Hong Kong Stock Exchange board of David Webb, due to pressure from China for a less transparent regime. There is a potential danger that Hong Kong’s corporate governance, based on the UK model, will gravitate towards Chinese practice.

2.5.7 Taiwan
Taiwan’s corporate regime is based on the German model (as with China) and it has a code of corporate governance to match. Many companies in Taiwan are family-controlled and corruption has been rife (where checking rigidities partly caused the 1997 crash). Timely payment of dividends is unusual and company reporting is laggardly. The Securities and Futures Institute has facilitated ‘quasi’ class-action lawsuits involving retail investors (Julian Roche). Taiwan is aiming to adopt IFRS accounting standards in time. Despite pervasive corruption, Taiwan was rated fourth in Asia for corporate governance by the Asia Corporate Governance Association in 2002 (after Singapore, Hong Kong and India).

2.5.8 India
India’s corporate governance has a Common Law framework and has been based on UK models. For many years following independence, India ran a managed economy-the ‘Licence Raj’, which avoided external investment and enabled Indian business groups to develop as conglomerates. Only in 1991 did India begin to liberalise its economy, just in time to avoid the worst of the 1997/8 Asian financial crisis, which gave impetus to a 1998 voluntary Code of Corporate Governance developed by the Confederation of Indian Industry (not the government). The Securities and Exchange Board of India (SEBI) followed up with recommendations which shaped Clause 49 of the listing Agreement (revised in 2006).
According to Chakrabarti et al (2008) the National Stock Exchange of India now functions with enough efficiency and transparency to generate the third largest volume of trades, behind NASDAQ and NYSE. In 2004, new measures based on Sarbanes-Oxley increased protection for minority shareholders, although family and government-controlled business groups continue to dominate Indian business. A growing number of companies are not ‘closed’, e.g., Infosys, and are breaking the hold of major groups in key areas. The role of international investors is likely to grow as India opens more business sectors to global competition. In 2005, the ACGA/CLSA ‘CG Watch’ survey rated India third in Asian economies for corporate governance, though India’s corporate governance culture only scored 43 per cent and enforcement 56 per cent. For its rules, India scored 66 per cent and for accounting standards 75 per cent. This emphasises the gap between expected standards and practice which persists in India. The need for foreign investment to enable India to optimise its economy and improve living standards for its population will in time overcome resistance from vested interests to the changes needed to fulfil India’s potential.

2.5.9 South Korea

South Korean company law is based on the German model. Its business structures were based on the Japanese model, with interlocking business groups operating as conglomerates (‘chaebol’). As in Japan, the chaebol were built up as aggressive export champions to win and exploit key Western markets. According to the Bank of Korea, the chaebol now control almost 40 per cent of the economy of South Korea.

Corporate governance structures are in place in South Korea but their effectiveness is mixed, despite the activism of groups like ‘People’s Solidarity for Participatory Democracy’ (PSPD). For instance, board committees are not required for companies capitalised at less than £1 billion. Only in 2005 were class-action lawsuits allowed for large companies. The Euromoney 2002 ratings for corporate governance showed Samsung Electronics top for South Korea with 57 votes, Kookmin Bank with 51 votes, followed by a sharp drop to 20 votes or less. A 2007 survey by FTI Consulting of over 200 top investors and advisers (www.fticonsulting.com) showed a positive correlation between effective governance and company value. Another study by Cheng (quoted by Julian Roche) found a negative relationship between tight corporate control and profitability among 400 chaebol affiliated firms.

Tolerance of chaebol has been weakened since 2007 by the sentencing to three years’ detention of Chung Mong-Koo, Chairman of Hyundai, for embezzlement. In 2008 Lee Kun-Lee, Chairman of Samsung Group, resigned in the face of criminal indictments. These events show that greater openness and willingness to ‘whistle blow’ are making chaebol more accountable to their increasingly international shareholders, who are now empowered to take class action against directors. However, until interlocking shareholdings are dismantled, incumbent family groups will be difficult to hold to account. In the words of Kim Sun-woong of the Centre for Good Corporate Governance, ‘Mr Lee hasn’t lost actual control. He doesn’t rule through the boards of directors.’ Mr Lee remains Samsung Group’s largest individual shareholder and heads of chaebol have rarely served long prison sentences.

2.5.10 Thailand

Thailand has the structure of corporate governance, including a detailed code. Until the 1997 financial crisis, corporate governance practice was poor, leading to overinvestment, over-borrowing and self-serving actions. Most Thai public companies were family controlled and exploiting of minority shareholders was rife. Following the crisis, corporate governance became a major issue, with 2002 being named as ‘The Year of Good Corporate Governance’ and the government appointing a National Corporate Governance Committee (NCGC). Focus is on enforcing existing laws and regulations rather than creating new ones. The task of enforcement is now entrusted to the NCGC, which has representatives of all bodies steering the economy (Central Bank, Stock Exchange, etc.). A study by McKinsey for the Thai Directors Institute sought to benchmark the state of corporate governance practice in 2001. Among its findings were the following:

- 76 per cent of companies surveyed had a majority of non-executive directors.
- 68 per cent of companies had boards with 25-50 per cent independent directors.
- 87 per cent of firms allowed sufficient time at shareholders’ meetings for them to ask questions. The study also noted examples of best practice in each of the survey categories.
The need was identified for the following:
• Minority shareholders to have a stronger voice in company affairs;
• Improvements in disclosure, transparency and communication.
• Greater regard for stakeholder groups, including employees.

In the 2002 ACGA/CLSA corporate governance rating within Asia, Thailand was rated eighth out of 10. It had 75 per cent for having rules but only 20 per cent for implementation. Thailand appears to lack a coherent strategy for implementing corporate governance and vested interests remain strong.

2.5.11 Singapore
Singapore depends on international commerce for its survival. As a result it has long had a strong legal and governance structure and been open to overseas investment. Singapore topped the ACGA/CLSA ‘CG Watch’ survey in 2004 with an overall score of 75 per cent. It was first in all five categories: rules, enforcement, political, IGAAP (International Generally Accepted Accounting Practice) and corporate governance culture. Some weakness remains, according to Jamie Allen of ACGA, in rules for board committees, nomination of independent directors by minority shareholders and in class action and mandatory poll arrangements. In enforcement, there are some inconsistencies, and there are weaknesses in the treatment of minority shareholders. In the political category there ‘remain some lingering perceptions of conflict of interest and lack of independence within the regulatory structure’. In respect of corporate governance culture ‘form over substance’ remains an issue; there are question marks over the role of investment banks and the relatively weak involvement of institutional shareholders. AGM attendance remains an issue, particularly for institutional investors who are not permitted to be on the shareholder register and can only be represented by custodian banks.

These points demonstrate the shortfall in corporate government practice even in an exemplary regime. Singapore’s ‘Code of Corporate Governance 2005’ is voluntary, but is backed by the Companies Act to provide a strong, but flexible model. Singapore is implementing IFRS using IGAAP and strengthening its accounting and audit regulations, so that a Sarbanes-Oxley model of corporate governance is not appropriate for an open and global market like Singapore, which is protected by stringent listing rules rather than post hoc controls. Competition between Singapore companies is intense and overseen rigorously by the competition Commission of Singapore.

2.5.12 Latin America
According to a 2005 study by Management and Excellence of Madrid, the rankings for ethics and sustainability (including corporate governance) of Latin American countries were as shown in Table 2.1. One of the basic problems faced by most Latin American countries is the fragility of democratic institutions, making the achievement of fair governance difficult and making the building of trust across society almost impossible in some cases.

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Country</th>
<th>Score</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Chile</td>
<td>74%</td>
<td>Corporate governance reforms 2000. Leads in anticorruption</td>
</tr>
<tr>
<td>2.</td>
<td>Mexico</td>
<td>60%</td>
<td>Sustained by the US proximity</td>
</tr>
<tr>
<td>3.</td>
<td>Argentina</td>
<td>59%</td>
<td>High public debt and inflation. Strong in education</td>
</tr>
<tr>
<td>4.</td>
<td>Peru</td>
<td>51%</td>
<td>(Mixture of international resource companies and local familial firms)</td>
</tr>
<tr>
<td>5.</td>
<td>Brazil</td>
<td>47%</td>
<td>Strong in corporate governance. Corruption a problem. Education poor</td>
</tr>
<tr>
<td>6.</td>
<td>Venezuela</td>
<td>47%</td>
<td>Equal worst in corporate governance. Low economic freedom. High inflation</td>
</tr>
<tr>
<td>7.</td>
<td>Ecuador</td>
<td>37%</td>
<td>Equal worst in corporate governance</td>
</tr>
<tr>
<td>8.</td>
<td>Colombia</td>
<td>31%</td>
<td>Crime and unemployment. Internal strife</td>
</tr>
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Table 2.1 Rankings by ethics and sustainability
2.5.13 Brazil

Brazil is a country with enormous potential and a prime target for overseas investment. Corporate governance is based on the 1976 Corporate Law and enshrined in the IBGC Code of Best Practice of Corporate Governance, developed by the Brazilian Institute of Corporate Governance out of world best practice. The first version was published in 1999; a fourth version is expected in 2008. One of the drivers for corporate governance standards in Brazil is the Stock Exchange (BOVESPA). BOVESPA established a New Market (Novo Mercado) in 2002 for companies willing to adopt tighter governance rules than those for the established board. The prevalence of family companies and cross-shareholdings in Brazil had created an ‘insider’ market; the Novo Mercado seeks to build an ‘outsider’ marketplace. In March 2007 it achieved its one-hundredth listing and almost all flotations are now on the Novo Mercado, where ‘capital pulverisation’ or free float shares are the norm.

The IBGC Code has evolved as follows up to Version 3 in 2004:

- It has four basic principles, transparency, fairness, rigorous accountancy and corporate responsibility.
- Provisions exist for the family mandate and non-audit services.
- Fuller details of committees, especially matching the Audit Committee with Sarbanes-Oxley.
- Clearer definition of director independence and continuous education requirement.
- Social and environmental responsibility practices.
- Detailed description of the duties and responsibilities of the Fiscal Council/Supervisory Board.
- Description of codes of conduct, related party transactions and conflicts of interest and risk management.

Brazil has made considerable progress in corporate governance to support the Novo Mercado initiative of BOVESPA. Its 47 per cent score on ethics and sustainability points up the need for wider reforms, particularly in crime and corruption and in making education available to the poor. The gap between the richest and poorest Brazilians is a major handicap in developing the country’s full potential and encouraging support for corporate governance.

2.5.14 Mexico

Mexico is largely shaped by its closeness to the USA. Its legal system is based on civil law, unlike the US Common Law foundation, and derived from Roman law. Many large companies, e.g., Telmex, were previously in the public sector, but some have been privatised. Mexico also has some major private companies, e.g., Cemex and Femsa, which operate on an international scale. Its largest industrialist is Carlos Slim Helu, who controls Telmex, Telcel and other companies, and is the second richest man in the world (after Warren Buffet). Below this level most Mexican companies are ‘closed’ or family-owned, with limited free float of shares. Governance has been seen as a problem, according to the IFC/World Bank, but a promised new Securities Law should improve the quoted sector. This introduces a new type of company, a Sociedad Anonima Promotora de Inversion (SAPI) which gives much clearer rights to minority shareholders than existing types of company.

Corporate governance in Mexico follows a voluntary Code issued in 1999 by the Stock Exchange and other financial bodies. The code focuses on the following areas:

- Board of directors (unitary board, with outside and ‘owning’ directors having at least 20 per cent each).
- Evaluating/compensating directors (board to be supported by internal/external experts).
- Audit (board to have internal/external expert advice).
- Finance and planning (internal audit, internal control system, compliance system, strategic planning system all required).
- Stockholder information (full briefing for general meetings, detailed annual report, contact with stockholders as needed).
In 2006 a revised Code was issued, seeking to further best practice. Emphasis is placed on the following aspects:

- Institutionalising processes; transparency.
- Adequate information disclosure.
- Competitiveness in a global world.
- Favourable access to finance.
- Implementing stable succession processes.
- Promoting the long-term sustainability of the company to benefit shareholders and stakeholders.

The new Code is intended for all Mexican companies, not solely quoted ones. It does not adopt the key elements of Sarbanes-Oxley, but seeks to pursue a path of principles and practice. This approach may not satisfy US interests.

2.5.15 Argentina

Argentina’s economy changed significantly with the privatisations of the early 1990s. This led to a debt-driven expansion, culminating in the 1999 financial crisis. Corporate governance in Argentina effectively began with the Latin American White Paper on Corporate Governance and the capital markets reform Decree 677/01/ of 2001. The White Paper follows the principles of the OECD Code and was developed by delegates from Brazil, Argentina, Mexico and Chile between 2000 and 2003. Key areas for action identified in the White Paper are:

- Respecting voting rights.
- Treating shareholders fairly during changes in corporate control and de-listings.
- Ensuring the integrity of financial reporting and improving disclosure.
- Developing effective boards of directors.
- Improving the quality, effectiveness and predictability of the legal and regulatory framework.
- Continuing cooperation across the Latin American region.

The Latin American Corporate Governance Round Table took stock of progress in 2005. In respect of Argentina some key points made were (according to the OECD) as follows:

- Institutional investors had not been as active as desirable.
- Efforts to equalise voting rights had made little progress.
- The OPA (Oferta Publica de Adquisicion Obligatoria) regime did not produce fair prices and needed to be made obligatory.
- Argentina should be represented on the board of the IASB to involve the country in international accounting standards.
- Internal politics continues to make directors loyal to the company and not to ‘their shareholder’.
- Investors lack the knowledge/will to press for their rights, including use of class actions.

A report on non-listed companies in 2006 by Dr Nagri (lawyer for the OECD) shows how the Companies Act has underpinned basic minority shareholder rights, conduct of meetings and basic disclosures. It recommends making all companies disclose to the level of the ‘advanced scrutiny regime’ (Section 299). This regime applies to larger and listed companies. Non-listed companies may follow the ‘IAGO’ Code of Best Practices for Corporate Governance, based on the OECD Code. The IAGO Code calls for as follows:

- An audit committee
- A compensation committee
- A nominating/corporate governance committee
- A finance committee
As most of these are ‘closed’ or family firms, this requirement is audacious! Argentina may be starting to move towards international levels of corporate governance but there is a strong history of building interlocking holdings, e.g., Pampa Energia and the recent re-nationalisation of Aerolineas Argentinas may herald an autarchic trend.

2.5.16 Chile

Chile moved early to modernise its economy after the banking crisis of 1982/3 and the departure of President Pinochet. The need to improve its international profile led to the Tender Offers and Corporate Governance Law 2000, which changed the workings of capital markets in Chile. Chile also adopted the OECD Principles of the Latin American Corporate Governance Round Table and had its own Code in 2001. Another driver of better governance was the pension-reform of the Chilean government, which mandated universal pensions whose funds were later privatised. Chile now has a more open economy than many of its peers, though they are catching up in terms of the IMF Corporate Governance Quality Index. Despite early progress, Chile still retains concentrated ownership, widespread use of pyramid structures and opaqueness in respect of ultimate ownership.

2.5.17 Venezuela

Venezuela scores lower than Chile in the IMF Corporate Governance Quality Index 2006. Many key companies are state owned, e.g., Petroleos de Venezuela, and there are several large companies with interlocking shareholdings. 95 per cent of the Venezuelan economy is sustained by small and medium-sized companies, most of which also interact financially.

Venezuela is not fertile territory for corporate governance, but the Venezuelan Association of Executives has developed a report, modelled on OECD principles, which is available for use voluntarily. As Venezuela is based on ‘insider’ systems, there is considerable resistance to the adoption of the report’s recommendations, particularly in respect of information disclosure and outside influence. Recent studies by McKinsey have revealed the need for ‘close’ companies in Latin America to reform themselves to compete with multinationals. To do so many will need to attract external investors.

One factor which weighs on Venezuelan corporate governance is President Chavez and Chavistan economics. Moves against foreign holdings have created growing cronyism among the political elite. Large sums of money have disappeared during nationalisation, and political meddling is progressively undermining corporate governance. Foreign investment is not needed while the oil continues to flow, so that Venezuela is likely to become autarchic.

2.6 Gulf Co-operation Council (GCC)

Corporate governance in the GCC zone is promoted by Hawkamah, the Institute for Corporate Governance, and an activist body with influence in the UAE, Oman, Kuwait, Bahrain and Saudi Arabia. Hawkamah cooperates with the Institute of International Finance and with capital markets, central banks and regulators in the GCC zone. Hawkamah is based in Dubai.

A survey by Hawkamah/IIF in 2006 showed how downward corrections in GCC markets had been driving improvements in corporate governance in the zone. Awareness of the benefits of good governance was increasing and all regulators were seeking to upgrade corporate governance frameworks. Muscat and Abu Dhabi had introduced codes in 2003 and 2006 respectively, and draft codes in the UAE, Saudi Arabia, Bahrain, Qatar and Kuwait were expected to be introduced in 2007. Increasing international activity by GCC companies was another important driver of improvements in corporate governance. In the year preceding the report (September 2006) overseas acquisitions had totalled $25.9 billion (Bloomberg). Opening GCC stock markets to foreign investors was the third key driver of improvements, in particular in transparency, disclosure in financial statements, board structure and risk management.

One of the issues affecting GCC corporate governance is the difficulty of finding independent directors. With multiple cross-holding of shares GCC boards tend to focus on separate shareholder concerns rather than the overall interests of the company. The lack of foreign and women directors limits the range of choice; a 2008 study by Hawkamah shows that of 4,254 board seats in Gulf companies only 63 are held by women. This is despite the considerable wealth of women in GCC economies. An increase in foreign directors may be expected as overseas investors buy into Gulf companies.
A survey by HSBC of institutional investors based in the GCC endorsed the region’s listed financial institutions, which are now preferred to real estate and telecoms. Ranking of markets put Kuwait first, Dubai second and Saudi Arabia third. 64 per cent of investors found poor corporate governance to be ‘a significant barrier’ to market performance. Ranking for corporate governance placed Kuwait first and then Oman. 34 per cent of respondents could not offer an answer to this question. Saudi Arabia and Dubai were cited as the worst markets for corporate governance. As they are the two most actively traded GCC markets, this finding is disturbing. HSBC’s Neil Foster said, “The message about corporate governance would appear to be: the higher the levels of governance, the more likely the investment community will rate your stock.” This is a lesson brought home to Dubai by its economic collapse in 2009.

A report by IIF in 2006 recommended the following actions to bring GCC corporate governance up to a standard sufficient to encourage foreign investment as follows:

- Political and government authorities to commit themselves to be proactive in improving corporate governance.
- GCC regulators to work together better in order to strengthen the region’s equity markets;
- Specialised courts to be established to enforce securities laws.
- Increase financial transparency by harmonising financial reporting requirements across the region.
- Establish a register of companies, requiring all companies (from sole proprietorship to joint stock companies) to provide standardised information.

It is apparent that corporate governance has not been embraced across the Gulf region and that ‘insider’ systems still predominate. Saudi Arabia’s Tadawul has only 115 quoted companies, yet claims to be the eleventh largest stock exchange in the world.

GCC and other Muslim economies need to reconcile their corporate governance models with Sharia law. A study undertaken by Abdullah al-Ahsan and Stephen B Young (2009), published by International Islamic University Malaysia and Caux Round Table, addresses this issue and offers guidance. At the heart of this guidance is the concept that law is ‘God’s Law’, so that respect for law and justice is absolute. Rules are likely to prevail over principles in a Sharia context.

2.6.1 Egypt

Egypt has declined in recent years from being the second economy in the Middle East to being fourth. It has an active twin stock exchange in Cairo and Alexandria (CASE), which was reformed in 2002 with new listing rules. As a result listed companies declined from 1,200 to 766, but capitalisation quadrupled to $52 billion. With support from the 10 largest companies a Code of Corporate Governance was published in 2005 with the participation of the business community. The Code reflects the OECD Code and has borrowed from others, e.g., South Africa, Malaysia and Philippines. The Code is primarily aimed at companies quoted on CASE, but is recommended to all others. It recommends corporate governance as ‘a culture and way of managing the relationship between owners of the company, its directors, and its stakeholders. Hence the interest of the whole community becomes more achievable, when more people apply the Code provisions’. The benefits of corporate governance to the whole of Egyptian society is emphasised in an article in Al-Akram (2006/793) by Professor Doha Abdel-Hamid of the American University of Cairo. The article underlines the link between good governance and the increase in overseas investment needed to develop Egypt’s economy. In November 2006, H E Dr Mahmoud Mohiedin, Minister of Investment, stated: ‘The importance of corporate governance is very obvious because you can’t have efficient markets without having disciplined corporations’.

Progress in Egypt is slow and most companies are ‘closed’ or family-owned, with cross-holdings of shares very common. Egypt has a culture of corruption which damages its economic progress. In the Transparency International Index for 2007, Egypt ranks 105 out of 179 worldwide for corruption. Progress with corporate governance in Egypt is likely to be slow; Egypt’s largest business sector is tourism, which only requires selective foreign investment.
2.6.2 Nigeria

Nigeria is Africa’s second largest economy, after South Africa, yet has consistently failed to realise its potential. Successive military regimes have been succeeded by an elected one, and the late President Yar’Adua had begun to reform key parts of the economy, including the oil industry and banking. In 2005 Nigeria’s banking industry was consolidated from 89 to 24 banks and in 2006 an obligatory Code of Corporate Governance was issued. Other sectors of the economy continue to follow the voluntary Code of 2003, developed by the Securities and Exchange Commission of Nigeria.

The 2006 Banking Code cites the following weaknesses targeted by its use:
- Disagreements between board and management giving rise to board squabbles.
- Ineffective board oversight functions.
- Fraudulent and self-serving practices among members of the board, management and staff.
- Overbearing influence of chairman or MD/CEO, especially in family controlled banks.
- Weak internal controls.
- Non-compliance with laid down internal controls and operation procedures.
- Ignorance of and non-compliance with rules, laws and regulations guiding banking business.
- Passive shareholders.
- Poor risk management practices resulting in large quantum of non-performing credits including insider related credits.
- Abuses in lending, including lending in excess of single obligor limit.
- Sit-tight directors – even when such directors fail to make meaningful contributions to the growth and development of the bank.
- Succumbing to pressure from other stakeholders, e.g., shareholders’ appetite for high dividends and depositors quest for high interest on deposits.
- Technical incompetence, poor leadership and administrative ability.
- Inability to plan and respond to changing business circumstances.
- Ineffective management information system.

A report in The Economist (23 August 2008) suggests that this reform has only had limited success. Banking standards have improved marginally, but the share values of banks have been boosted by risky loans to investors to buy bank shares. Confidence has ebbed and shares have been falling since 2008.

A study by Sanda, Mikailu and Garba (2005) looked at corporate governance mechanisms and firm financial performance in Nigeria. It points to ‘a yawning gap between theory and evidence’ driven by an endemic agency problem. The study concludes that boards need 10 directors to function effectively and that the functions of chairman and CEO need to be separate. One challenging finding is that firms run by expatriate CEOs tend to perform better than those led by indigenous ones. Procedures for appointing outside directors need to be reasserted to remove the influence of CEOs on the appointment process.

The progress of corporate governance in Nigeria is slow and uneven. Nigeria is 147th out of 179 in the Transparency International Index of corruption in 2007. The arrival of Chinese investment on a significant scale since Hu Jintao’s visit in 2006 is likely to ‘muddy the waters’ even further by reducing emphasis on corporate governance. The election of Goodluck Jonathan as president in 2011 may be harbinger of better progress in corporate governance over time.
2.6.3 Morocco
In February 2007, a National Commission on Corporate Governance was established to prepare a Moroccan Code of Good Corporate Governance Practices. The Code was promulgated in March 2008, based on OECD principles, and adapted to the Moroccan economic fabric. Technical assistance was provided by the Global Corporate Governance Forum and IFC. The Code is intended to underpin Moroccan companies in a world of global competition, and has involved all parties in Moroccan business administration. The Code also intends to optimise access to financing at economic rates, to build confidence among national and foreign investors in Moroccan companies and to improve and solidify relations among all stakeholders. It is intended to supplement the Code with targeted codes for SMEs and family-owned businesses, credit institutions and publicly-owned subsidiaries and mixed-capital companies. It is intended to review the Code at periodic intervals.

2.6.4 Africa overall
The best picture of the total African governance situation is provided by ‘The Ibrahim Index on African Governance’, published by the Mo Ibrahim Foundation in 2007 and covering 48 sub-Saharan African countries. The purpose of the Index is to drive improvement in African governance, and consequently in corporate governance. The rankings are constructed from the bottom up, so that they reflect local opinions as far as possible. The Index is led by Mauritius, Seychelles, Botswana, Cape Verde, South Africa (in that order), with the worst performers (bottom upwards) being Somalia, Democratic Republic of Congo, Chad, Sudan and Guinea-Bissau. Nigeria is in 37th place out of 48. Between 2000 and 2005, the most improved countries were Angola, Rwanda, Eritrea, Burundi and Sierra Leone.

2.7 Conclusions
What are the common features that emerge from this global pattern and have potential relevance for the future of corporate governance? The key problems shared by most countries in varying degrees are as follows:

- Concentration of power with major holdings dominating the board (supported by pyramid schemes, cross-shareholdings and/or weighted shares).
- Minority shareholders at a grave disadvantage (often with little/no legal redress).
- Monolithic boards, with few (if any) independent directors (few women or minority groups).
- Poor transparency in documentation or process.
- Weak accountability of directors (with little recourse).
- Corruption in various forms (favouring friends and family is often less damaging than third-party corruption).
- Creditors’ rights poorly protected (late payments, etc.).
- Government interference evident in some countries (latent in most).
- Lack of stakeholder involvement (other than through the letter of the law).

The IMF Working Paper WP/06/293 (IMF 2006) on corporate governance quality constructs a composite index from 1994 to 2003 in selected emerging and developed countries, and assesses its impact on aggregate and corporate growth and productivity. Its key findings over the period are:

- Corporate governance quality in most countries has improved, in varying degrees, with a few notable exceptions. One of these is Iceland, which is threatening to renege on sovereign debts, following its banking scandal.
- The data exhibit cross-country convergence, with a high catch-up rate in many cases.
- The impact of improvements in corporate governance quality on traditional measures of economic activity, GDP growth, productivity growth, ration of investment to GDP is positive, significant and quantitatively relevant, and the growth is particularly pronounced for industries that are most dependent on external finance.

By contrast, the World Bank sponsored ‘Governance Matters’ study (2008) shows little average improvement in the year before publication. ‘Every region has good examples of improvement like Liberia under President Ellen Johnson Sirleaf. However, for every Liberia you have a Zimbabwe.’ The study found that several emerging and transition economies, including Slovenia, Czech Republic, Hungary, Estonia, Latvia, Lithuania, Botswana, Mauritius, Chile and Costa Rica, score better than some industrialised nations, such as Italy and Greece. It is likely that the one-year
focus of the study hides trends which emerge more clearly in the IMF Working Paper WP/06/293 (IMF 2006). What are the key potential actions which will improve the average level of ‘corporate governance quality’ and what may be the benefits? A shortlist for further consideration might include the following:

- Improve the predictability of laws to protect all investors, not just powerful national groups.
- Improve the mobility of invested funds (and protect them from expropriation).
- Minimise the involvement of governments in the marketplace (no national champions, etc.).
- Improve company law and regulation to set high standards and prevent abuse.

These actions will encourage foreign investment and create a level playing field for all participants in the marketplace. A stronger legal and regulatory framework will provide a firm basis to develop improved governance practices, leading to increased overseas investment and transfer of knowledge. Achieving such an outcome is difficult, as EU reports on Bulgaria and Romania will underline. On the other hand, if successful this process will stimulate competition and drive down costs in the host country, promoting innovation and liberating the talent of the local population. The link between good corporate governance and improved profitability has been demonstrated in many instances. This is a major opportunity to confirm that link and produce the benefits it has promised on a wider scale.
Summary

- There is no unanimity of purpose or structures in corporate governance.
- Corporate raiders and leveraged buyout (LBO) specialists used debt to buy companies and drove up performance to enrich themselves.
- Corporate executives were quick to learn this new game and have increased their own earning capacity, largely through
  - The Act places the Audit Committee in control of internal audit and all links with the external auditor; audit committees are composed solely of independent directors, at least one of whom must be a ‘financial expert’.
- Sarbanes-Oxley has galvanised US corporate governance but its costs are high and have hurt smaller companies.
- As US companies have primarily been run by executive committees rather than the board, power has been largely concentrated in those committees, and in particular, their leader, the CEO.
- International law has laid down clear principles to allow the exercise of jurisdiction.
  - The USA has been active in attacking offshore registration regimes, under the pretext of preventing money laundering for terrorists.
- The UK regime is well respected internationally, both as a pioneer and model, and as an approach to governance which is pragmatic and not excessively bureaucratic or expensive.
- The foundations for corporate governance in Canada were laid in the Dey Committee Report of 1994.
- Australian capitalism has developed out of a ‘frontier spirit’ epitomised by ‘cowboys’ like Alan Bond, into larger scale and maturity.
- Corporate governance is an import into New Zealand, based on UK and US models and seen as necessary to encourage outside investment. In 2004
  - The 1994 King Report was sponsored by the IOD, and stimulated interest in corporate governance, leading to the definitive King Report of 2002.
- Company law and corporate governance in Ireland have broadly followed models from the USA and the UK in the past.
- Franco created a state owned industrial structure, similar to that of Mussolini, which has been slowly dismantled and largely privatised to a large extent.
- ‘Every region has good examples of improvement, like Liberia under President Ellen Johnson Sirleaf.
- A stronger legal and regulatory framework will provide a firm basis to develop improved governance practices, leading to increased overseas investment and transfer of knowledge.

References

- CFA Level I Corporate Governance Video Lecture by Mr. Arif Irfanullah. [Video online] Available at: <http://www.youtube.com/watch?v=ddLki6JvcMQ> [Accessed 28 January 2014].
Recommended Reading


Self Assessment

1. Which of the following sees Henry Kravis of KKR, and other corporate raiders of the 1980s, as the architects of today’s corporate governance in the USA?
   a. Professor Kaplan of Chicago Business School
   c. D.J Ash of Chicago Business School
   d. Professor Choquet of Chicago Business School

2. _________ law has laid down clear principles to allow the exercise of jurisdiction.
   a. National
   b. International
   c. Corporate
   d. Business

3. Match the following

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<td>1. The UK regime</td>
<td>A. its economy has been built largely on smaller companies, with a strong bias towards exporting.</td>
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<tr>
<td>2. Canada</td>
<td>B. It has developed out of a ‘frontier spirit’ epitomised by ‘cowboys’ like Alan Bond, into larger scale and maturity.</td>
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<tr>
<td>3. Australian capitalism</td>
<td>C. It is well respected internationally, both as a pioneer and model, and as an approach to governance which is pragmatic and not excessively bureaucratic or expensive.</td>
</tr>
<tr>
<td>4. New Zealand</td>
<td>D. The foundations for corporate governance in here were laid in the Dey Committee Report of 1994.</td>
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   a. 1-B, 2-A, 3-D, 4-C
   b. 1-A, 2-B, 3-C, 4-D
   c. 1-C, 2-D, 3-B, 4-A
   d. 1-D, 2-C, 3-A, 4-B

4. Who has suggested that the Australian system is evolving into an ‘outsider’ one, due to the growth of the Australian stock market and institutional investment in it?
   a. Professor Kaplan
   b. Jay W Lorsh
   c. Brian Cheffins
   d. Professor Choquet

5. BHP was founded in _______, as Broken Hill Proprietary Company and grew steadily within Australia until the 1960s.
   a. 1855
   b. 1865
   c. 1895
   d. 1885
6. Which of the following statement is true?
   a. New economy has been built largely on smaller companies, with a strong bias towards exporting.
   b. New Zealand’s economy has been built largely on smaller companies, with a strong bias towards exporting.
   c. USA’s economy has been built largely on smaller companies, with a strong bias towards exporting.
   d. UK’s economy has been built largely on smaller companies, with a strong bias towards exporting.

7. Which of the following statement is false?
   a. In a small country, business leaders know each other well, and ‘clubby’ relationships develop.
   b. A 2003 paper from the law firm Chapman Tripp was also critical of the New Zealand Stock
   c. Apartheid collapsed in 1994, reopening the South African market to international investment.
   d. Company law and corporate governance in Ireland have broadly followed models from the New Zealand and the Japan in the past.

8. A new Companies Bill provides for the consolidation of _____ earlier legislation and gives greater clarity to practitioners.
   a. some
   b. all
   c. two
   d. four

9. Which of the following created a state owned industrial structure, similar to that of Mussolini, which has been slowly dismantled and largely privatised to a large extent?
   a. Franco
   b. Max
   c. Mosson
   d. Brian

10. In ____ the Draghi Commission recommended reforms to bring Italian corporate governance closer in line with OECD guidelines.
    a. 1995
    b. 1997
    c. 1996
    d. 1998
Chapter III

Regulatory Framework for Corporate Governance in India

Aim

The aim of this chapter is to:

- introduce evolution of corporate governance in India
- explain clause 49 of the listing agreement
- explicate the provisions under clause 49 of the listing agreement

Objectives

The objectives of this chapter are to:

- enlist corporate governance voluntary guidelines-2009
- elucidate the companies act 1956
- explain the companies bill, 2008

Learning outcome

At the end of this chapter, you will be able to:

- identify the companies amendment bill, 2011
- understand corporate governance rating
- recognise national voluntary guidelines for social, environmental and economic responsibilities of business-July, 2011
3.1 Introduction

Corporate governance has become a central issue in developing countries particularly since the Asian crisis, which is believed to have been partly caused by poor governance and lack of transparency in East Asian countries. Asian economies as a group share certain common features that affect the governance practices in the region. Businesses in most Asian countries are marked with concentrated ownership and preponderance of family control or state control forming an important component of the corporate sector in these countries. This has led to what is known as pyramiding of corporate control, tunneling of corporate gains to other family-owned entities and expropriation of minority shareholder value. It is due to the prevalence of these practices that the legal framework for corporate governance in these Asian countries and India has come under strict scrutiny.

In terms of corporate laws and financial regulations, India has emerged far better than other East Asian countries. The Companies Act 1956 has been the foundation of Corporate Governance and Accounting Systems in India. Wide-ranging changes were brought about in the laws and regulations relating to the financial markets since liberalisation. The single most important development has been the establishment of Securities and Exchange Board of India (SEBI) in 1992. SEBI has played a crucial role in establishing the basic minimum compliance norms for corporate governance by listed companies.

The CII initiative

With the opening of the economy and increased competition under the liberalised regime, concerns were raised regarding corporate governance practices in India. The process of restructuring of the corporate governance framework and development of a code of corporate governance was initiated by CII in 1996. A national task force was set up under the chairmanship of Rahul Bajaj, past president of CII and presently chairman of the Bajaj Group. The task force made a number of recommendations relating to board constitution, role of non-executive directors, role of audit committees and others. The committee submitted its code in 1998.

SEBI sets up Kumar Mangalam Birla committee

In 1999, SEBI set up a committee under the chairmanship of Kumar Mangalam Birla, to suggest suitable recommendations for the listing agreement of companies with their stock exchanges to improve the existing standards of corporate governance in the listed companies. The committee paid much attention to the role and composition of the board of directors, disclosure laws and share transfers. Recognising that accountability, transparency and equal treatment of all stakeholders are the key elements of corporate governance the committee evolved a code of governance in the context of the prevailing conditions in the capital market. The code was accepted in 2000 by SEBI and incorporated into a new clause 49, which was inserted into the listing agreement of companies with their stock exchanges.

3.2 Clause 49 of the Listing Agreement

The provisions of this clause are applicable to all entities seeking listing approval and having a paid up capital of Rs. 3.0 crore and above or a net worth of Rs. 25 crore or more at any time in the history of the company. The provisions contained in clause 49, took effect in phases between 2000 and 2003 as described later in this chapter.

RBI advisory group headed by Dr. R H Patil

The recommendations of this group which were submitted to SEBI in 2001, covered some more codes and principles of private sector companies including consolidation of accounts incorporating performance of subsidiaries, criteria of independent directors and disclosures.

N R Narayan Murthy committee

In 2002, SEBI constituted another committee under the chairmanship of N R Narayan Murthy the then chief mentor of Infosys Technologies Ltd., to further streamline the provisions of clause 49. Based on the recommendations of the committee, SEBI revised some sections of the clause in August 2003 and later once again after further deliberations in December 2003.
In October 2004, SEBI published a revised clause 49, relating to corporate governance, which set forth a schedule for newly listed companies and those already listed to comply with the revisions. Major changes in the clause included amendments/additions to provisions relating definition of independent directors, strengthening the responsibility of audit committees and requiring boards to adopt a formal code of conduct. Later, the date for compliance with these new provisions was extended to December 2005, since a large number of companies were unprepared to fully implement the changes.

In January 2006, SEBI issued some further clarifications on clause 49 which included:

- The maximum time gap between board meetings of listed companies to be increased from three to four months.
- Sitting fees paid to non-executive directors would not require the previous approval of shareholders
- Certifications of internal controls and internal control systems by CEOs and CFOs would cover financial reporting only.

The revised clause 49 came into effect on January 13, 2006. Further amendments were made in some of the provisions of the Clause in July 2007 which dealt with quarterly reporting. SEBI made it optional for companies to both present an unaudited or audited quarterly result, and year to date financial results to stock exchanges within one month from the end of each quarter. If the option is to present unaudited results, then the results will be subject to limited review and the report will have to be submitted to SEs within two months from the end of the quarter.

3.3 Provisions under Clause 49 of the Listing Agreement

In its final form, the Clause 49 of the Listing Agreement covered the following provisions regarding corporate governance by listed companies.

**Mandatory provisions**

The mandatory provisions are as follows:

- Board of directors: Composition of the board, definition of independent directors and proportion of independent directors in the total board strength, compensation of non-executive directors and disclosures, board meetings, information to be made available to the board, membership of board-level committees by the directors and code of conduct.
- Audit committee: Its constitution, its meetings, role, powers and review of information.
- Subsidiary companies: Number of subsidiaries, review of financial statements of the subsidiaries by the holding company, transactions of the listed holding company with the subsidiaries and other related disclosures.
- Disclosures: These include a series of mandatory disclosures like basis of related party transactions, accounting treatment, risk management, utilisation of proceeds of public issues, remuneration of directors, management discussion and analysis report in the company’s annual report, setting up of shareholders/investors grievances committee and other items to be reported to the shareholders.
- CEO/CFO certification: This certification relates to the review of financial statements and cash flow statements by the CFO, compliance with existing accounting standards, laws and regulations, responsibility for maintaining internal controls, etc.
- Separate section in the company’s annual report on corporate governance.
- Compliance certificate from auditors or practicing company secretaries non-mandatory requirements.

These included provisions regarding the following:

- Tenure of independent directors.
- Constitution of the remuneration committee.
- Declaration of half-yearly financial performance including summary of significant events to be sent to shareholders’ residences.
- Progression towards a regime of unqualified financial statements.
• Training of board members in the business model and risk profile of business parameters of the company including their responsibilities.
• Evaluation of non-executive board members.
• Whistle blower policy.

To curb the recurrence of accounting scandals like the one at Satyam Computers, a panel of experts was set up at SEBI. This panel recommended the following:
• Rotation of audit partners
• Selection of CFO by the company’s audit committee
• Standardisation of disclosure of earnings
• Streamlining the submission of financial results

SEBI has amended the listing agreement to include the above recommendations. SEBI issued several circulars relating to amendments regarding applicability and enforcement of corporate governance provisions.

3.4 Corporate Governance Voluntary Guidelines-2009

During India corporate week in December 2009, the ministry of corporate affairs brought out a set of voluntary guidelines for improvement of corporate governance practices by the listed companies. The objective of the guidelines was to encourage the use of better governance practices through voluntary adoption. The guidelines issued a series of recommendations elaborating the various mandatory and non-mandatory provisions of clause 49 of the listing agreement and suggested that the companies could adopt them on a voluntary basis in order to further improve their governance practices. The major recommendations referred to:

• Board of directors: Appointment of directors, separation of offices of chairman and CEO, nomination committee and maximum limit of directorships in public limited and private companies that are either holding or subsidiary companies of public companies.
• Independent directors: Attributes of independent directors and their certification of independence, tenure of independent directors (not more than six years).
• Remuneration of directors: Guiding principles relating to remuneration of directors including non-executive and independent directors suggested which should link corporate and individual performance. Incentive schemes should be designed around appropriate performance benchmarks with rewards for materially improved company performance. There should be a suitable balance between fixed and variable remuneration. Performance-related component of remuneration should form a significant proportion of the package. Remuneration policy for board members and key executives should be announced.
• Remuneration of non-executive and independent directors: Non-executive directors to be paid a fixed contractual remuneration subject to an appropriate ceiling and an appropriate percent of net profits of the company. Uniform remuneration for all non-executive directors. Independent directors to be paid adequate sitting fees depending on criteria of net worth and turnover. No stock options for independent directors, so as not to compromise their independence.
• Responsibilities of remuneration committee and procedures relating to annual evaluation of performance of directors.
• Training of directors through suitable methods to enrich their skills.
• Risk management: Board to affirm and report the framework and oversee the system every six months.
• Board evaluation: Performance of directors and committees thereof to be evaluated.
• Audit committee of the board: More elaborations on the powers, role and responsibilities of the audit committee
• Appointment of internal auditors: Internal auditor should not be an employee of the company to ensure credibility and independence of the audit process.
• Certification of independence from auditors: Affirmation of arm’s length relationship with the auditors.
Corporate Governance and Business Ethics

- Rotation of audit partners and audit firms: Audit partners every three years and audit firm every five years.
- Secretarial audit.
- Institution of mechanism for whistle blowing.

These guidelines are expected to serve as a benchmark for the corporate sector and would also help the sector in achieving the highest governance standards. Adoption of the guidelines would also translate into much higher level of stakeholder confidence which is crucial to ensure long-term sustainability and value-generation by businesses. These guidelines were very detailed and not all companies are known to have fully adopted these guidelines.

### 3.5 National Voluntary Guidelines for Social, Environmental and Economic Responsibilities of Business—July, 2011

These form a refinement over the earlier corporate social responsibility voluntary guidelines, 2009 and are designed for all businesses irrespective of size, sector or location.

The guidelines have nine basic principles as follows:

- Businesses should conduct and govern themselves with ethics, transparency and accountability.
- Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycles.
- Businesses should promote the wellbeing of all employees.
- Businesses should respect the interests of and be responsible towards all stakeholders, especially those disadvantaged, vulnerable and marginalised.
- Businesses should respect and promote human rights.
- Businesses should respect, protect and make efforts to restore the environment.
- Businesses when influencing public and regulatory policy should do so in a responsible manner.
- Businesses should support inclusive growth and equitable development.
- Businesses should engage with and provide value to their customers and consumers in a responsible manner.

### 3.6 The Companies Act 1956

The Companies Act, 1956 provides the legal framework for corporate entities in India. The Act has made provisions for some aspects of corporate governance which include number, role, powers, duties and liabilities of directors and restrictions placed on them. Other provisions include number and frequency of board meetings, rights of minority shareholders, maintenance of books of accounts and development of accounting standards, audit obligations and report of auditors. 24 amendments have been made in the Act providing statutory provisions relating to corporate governance since 1956.

Several major amendments had been proposed in the Companies (Amendment Bill) 2003. However, their consideration has been held back in anticipation of a comprehensive review of the company law through a consultative process. In view of the changes in the national and international economic environment and the expansion and growth of our economy the Central Government had decided to repeal the Companies Act 1956 and enact a new legislation to provide for renewed provisions to enable an accelerated growth of the economy.

As a first step of the review, a concept paper on company law was drawn and put up on the electronic media for opinions and suggestions from all interested parties. The need was to bring about harmony between SEBI’s clause 49 provisions and those of corporate governance in the company’s Act.
**J J Irani Committee**

As a number of suggestions were received from various bodies on the concept paper, it was felt that these proposals should be evaluated by an expert committee. Hence in December 2004, a committee was constituted under the chairmanship of Dr. J J Irani the then director of Tata Sons. The objectives of the committee were to address the changes in the national and international scenario facing listed companies, enable internationally accepted best practices and provide adequate flexibility for timely evolution of legal reforms in response to the changing business models. The report of the committee was submitted in May, 2005.

**3.7 The Companies Bill, 2008**

On October 23, 2008, the Minister for Corporate Affairs introduced the new Companies Bill, 2008 into the parliament. It was subsequently referred to the department related, Parliamentary Standing Committee on Finance for examination and report. The bill sought to enable the corporate sector in India to operate in a regulatory environment of best international practices that foster entrepreneurship, investment and growth. A number of other improvements were proposed in the new bill including board meetings to be conducted through video conferencing and recognising votes cast through e-mail.

Before the report could be submitted by the parliamentary committee, the Loksabha was dissolved and the bill lapsed. It was later reintroduced without any change in August, 2009. It was again referred to the Parliamentary Standing Committee on Finance for examination and report. The committee gave its report on Aug. 31, 2010. During the period Central Government had received several suggestions from various stakeholders for amendments in the bill. The Parliamentary Committee had also made a large number of recommendations in its report. In view of the large number of amendments proposed in the Companies Bill, the Central Government decided to withdraw the Companies Bill 2009 and introduce a fresh bill, the companies Amendment Bill 2011 incorporating all the recommendations.

**3.8 The Companies Amendment Bill, 2011**

After six years, since the J J Irani Committee Report was submitted, the Companies Amendment Bill was tabled in the Parliament on Dec. 14, 2011. The bill was vetted by Parliament’s Standing Committee on Finance headed by former finance minister, Yashwant Sinha. The amendments in the bill are aimed at strengthening governance in companies and enhancing transparency. The new bill seeks to ensure greater board independence, higher levels of accountability through additional disclosure norms, facilitate raising of capital, protection of minority shareholders and setting up of a CSR Committee.

In brief, the following amendments have been recommended:

- Corporate social responsibility expenditure to be two percent of profit of last three years.
- A mandatory CSR committee.
- Independent directors to be appointed from a notified data bank containing names, addresses and qualifications of persons who are eligible. They can be appointed for two consecutive terms of five years each. A cooling off period of three years to be maintained before reappointment.
- A code of conduct for independent directors.
- Independent directors to give a declaration of independence every year.
- No stock option for independent directors.
- An individual auditor can be appointed for one term of five years and an audit firm for two terms of five years. A cooling off period of five years before reappointment.
- Auditors are not to provide non-audit services.
- An audit partner and his team may be changed every year by the company.
- Incoming audit firm and outgoing audit firm should not have common partners.
- An auditor should not hold any securities in the company or its subsidiaries or have any business interest with the company or be indebted to it or have a relative who is a director in the company.
- Secretarial audit: A practising company secretary to report to the board that the company has complied with all the requirements under the Companies Act as well as other laws applicable to the company.
- Companies to provide an exit option to minority shareholders who may disagree with the firm’s decision to acquire a firm do a corporate or loan restructuring or diversify into unrelated business area.
Apart from reducing the number of sections drastically, the bill has also prescribed 33 new concepts and definitions. We have briefly discussed below the proposed amendments pertaining to corporate governance.

3.8.1 Matters Relating to Incorporation of a Company

The matters relating to incorporation of a company are discussed in the paragraphs given below.

Declaration by the director

Within this list of amendments, the major one is the declaration by a director in a prescribed form that the subscribers have paid the value of shares agreed to be paid by them and a confirmation that the company has filed a verification of its registered office with the registrar.

Exit option for minority shareholders

A company which has raised money from public through a prospectus and has an unutilised amount out of the money so raised shall not change its objects unless a special resolution is passed and other requirements of advertisements are complied with. The company has to give an exit opportunity to dissenting shareholders and other investors, if they are not agreeable with the company’s diversification plans, acquisition of another firm, or a corporate or loan-restructuring plan or proposals for transfer or sale of the existing business.

The provision attempts to address typical issues in Indian companies where promoters holding majority of the shareholding generally ignore the voice of minority shareholders in some of their major corporate decisions. This amendment is now expected to give a greater say to the minority shareholders in the company’s business plans, many of which presently have the freedom and flexibility to buy, sell or merge and demerge businesses.

This is a minority investor-friendly move, but may prove to be cumbersome for the companies. The minority investors who wish to exit would not be simply selling their shares in the open market, but could demand a specific option more on the lines of a buyback or a delisting offer. Companies going through financial pressures and intending to sell their assets to raise funds may not be able to offer exit options to dissenting minority shareholders. Again if this is done the prevailing norm of 25 percent public holding of equity for listed companies may be difficult to comply with the given exit options.

3.8.2 Prospectus and Allotment of Securities

The bill governs the issue of all types of securities. Under the Companies Act, 1956, only shares and debentures were covered. The bill has included provisions which apply to public offer, private placement or issue by way of bonus or rights issue.

3.8.3 Share Capital and Debentures

Certain provisions have been included which relate to further issue of shares for increasing the subscribed paid up capital, voting power of preference shareholders, issue of bonus shares, buyback of shares, offer of shares to employees by way of ESOPs, etc. The scope of the section relating to transfer and transmission of securities has also been widened to include all types of securities. All these provisions will help the regulators in monitoring the entire paid up share capital of the company and also assess the number of shares held by various categories of shareholders and their voting power.
3.8.4 Management and Administration
The management and administration functions are explained below.

Additional information to be provided in the annual returns
The annual returns of the company have been elaborated to include additional information like particulars of its holdings and subsidiary and associate companies. It should also include changes in the number of shares held by promoters and top ten shareholders of the company and matters relating to certification of compliances, disclosures, remuneration of directors and key managerial personnel. In case of companies with prescribed paid up capital and turnover, certification of annual return by a practising company secretary has been made mandatory. These provisions will bring in greater transparency relating to shareholding by promoters and majority shareholders. Disclosures relating to key financial outflows of the company would help in monitoring them more effectively.

3.8.5 Accounts of Companies
The accounts of companies are explained in the paragraphs given below.

Scope of directors’ report widened
The bill recognises that books of accounts may be kept in electronic form. Balance Sheet and Profit and Loss Account have been defined collectively as Financial Statements. Along with financial statements, consolidated financial statements of all subsidiaries and associate companies shall be prepared and laid before the AGM. This disclosure of consolidated financial statements will bring to light all transactions done by the listed company with its subsidiaries and give an opportunity to minority shareholders to question suspect dealings with the associate companies.

The scope of the Directors’ Report has been widened to include additional information like number of board meetings, policy of the company relating to appointment of directors and their remuneration, explanation or comments by the board on every qualification, reservation or remark or disclaimer made by the company secretary in the Secretarial Audit Report, particulars relating to loans, guarantees, investments, etc. The Directors’ Responsibility Statement in case of a listed company should include additional statement relating to internal financial controls and compliance of all applicable laws.

These provisions have placed greater responsibility on the directors in the areas of loans and investments, appointment of directors and their remunerations, explanations with regard to audit qualifications, and commitment on internal controls and compliance with all types of regulations. Directors’ Report and Directors’ Responsibility Statement being part of the published annual report will make all the shareholders aware of the decisions taken by the board in these key areas of governance and any shortcoming can be challenged by the shareholders and investors.

Corporate social responsibility
Every company having a net worth of Rs. 500 crore or more or turnover of Rs. 1,000 crore or more or a net profit of Rs. 5.0 crore shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors (at least one being an independent director). The committee will recommend the CSR policy of the Board. The Board of every such company must ensure that in every financial year the company spends at least two percent of the average net profit of the company made during the three immediately preceding financial years in pursuance of the CSR policy. Failure in compliance needs to be reported with reasons thereof in the Directors’ report.

This move to make CSR compulsory for certain high net worth companies will ensure that this function of giving back to the Society is taken more seriously and made sustainable by the promoters and directors of the company. Earlier it was treated as a mere compulsion with some funds channelised in this direction. With the passing of the bill, there will be a commitment to ensure that a certain percentage of profits flow into CSR activities every year. This is an excellent provision in the direction of inclusive growth and social sector reforms.
3.8.6 Audit and Auditors
The audit process and the responsibilities of auditors are explained in the paragraphs given below.

Rotation of auditors and audit firms
The bill provides for compulsory rotation of individual auditors every five years and of audit firm every ten years for listed and certain other class of companies. A transition period of three years has been provided to comply with this provision.

Prescription of auditing standards
Central Government will prescribe the auditing standards as recommended by the Institute of Chartered Accountants in consultation with the National Financial Reporting Authority.

Responsibilities of auditors
Auditors have to comply with auditing standards. Certain new provisions for disqualification of auditors have also been prescribed. Partner or partners of the audit firm and the firm shall be jointly and severally responsible for the liability, whether civil or criminal as provided in the Act or any other law. If any fraudulent practice civil or criminal, by the auditors is proved the Audit partner/partners and the firm are punishable.

The prescriptions for Auditors and their compulsory rotation every five years together with compliance to auditing standards recommended by Institute of Chartered Accountants of India will ensure complete transparency in the internal workings of companies in order to avoid any future Satyam like scams.

3.8.7 Appointment and Qualification of Directors
The provisions related to appointment and qualifications of directors are explained below.

Appointment of independent directors (IDs)
One of the major criticisms of the current policy of appointment of independent directors is that the promoters exert tremendous influence in determining and appointing independent directors. This issue has been addressed by making it mandatory for all listed and certain other class of companies to constitute a nomination and remuneration committee consisting of three or more non-executive directors of which not less than half should be independent directors. The Committee has to consider candidates for appointments as IDs and recommend them to the board. The bill also proposes the formation of a Databank of IDs from which suitable persons may be selected.

This is expected to bring in greater objectivity in to the process of nomination of IDs and preclude the influence of promoters on them. The bill prescribes that at least one-third of the directors on the board should be IDs. This is a departure from the prevailing norms, wherein half the directors had to be independent in case the company has an Executive Chairman or he is related to the promoter of the company. This represents a dilution from the existing position. The bill also provides for at least one woman director on the board.

The definition of an ID has been considerably tightened
The definition now includes positive attributes of independence, namely that the Director should be a person of integrity and possess relevant expertise and experience in the opinion of the Board. Central government is also vested with powers to prescribe qualifications of IDs. Every ID is required to declare that he or she meets the criteria of independence. Participation of minority shareholders in the appointment of IDs has been kept non-mandatory.

Directorship in not more than 20 companies
The number of companies in which a person can be a director has been increased from 15 to 20. Of the 20, he cannot become a director in more than 10 companies.

Role and functions
Section IV of the bill lays down the code which sets out the role functions and duties of the IDs and also those relating to their appointment, resignation and evaluation. These prescriptions make the role of the IDs quite onerous and could enhance the level of monitoring of the listed companies which is so crucial for good governance practices.
Liability of the IDs
The bill limits the liability of the ID only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes and with his consent or connivance or where he had not acted diligently.

Remuneration
In a break from the earlier norms, an ID is entitled only to fees for attending meetings of the boards and possibly commissions within certain limits. The bill expressly disallows IDs from obtaining stock options. Companies may find it difficult to get directors of the requisite calibre unless they are appropriately remunerated.

Tenure
To ensure that IDs maintain their independence, the term of their tenure has been prescribed. The initial term is prescribed as five years following which further appointment would require a special shareholder resolution. The total tenure shall not exceed two consecutive terms.

All the provisions relating to IDs, their appointment procedures, their liabilities, tenure, role and functions are in the right direction and place greater responsibilities on the IDs which were very vital for ensuring greater board independence. The liabilities of IDs are limited to acts which have occurred with his knowledge or in his presence. This provides a safeguard mechanism for the ID, who need not be held liable for all board decisions, even those taken without his presence.

Mandatory constitution of Nomination and Remuneration Committee, Stakeholders Relationship Committee and CSR Committee means that the IDs and Non-executive Directors would be more involved in the operations of the company and would have to take greater interest in the appointment of Directors and key management personnel. They will also have to be more engaged with all the stakeholders and resolve grievances of all security holders.

3.8.8 Meetings of Board and its Powers
The meetings of board and its powers are listed below.

Audit committee
Composition of the Audit Committee has been changed. The committee shall now comprise of three minimum directors, majority of them being independent directors. Majority of them should also be having the ability to read and understand financial statements.

Vigilance mechanism
Every listed company and such other class of companies shall have a vigilance mechanism in the prescribed manner.

Stakeholder’s relationship committee
Every company which has more than 1000 shareholders, debenture holders or deposit holders shall constitute a Stakeholders Relationship committee consisting of a Chairman who is a non-executive director and such others as may be decided by the board.

Disclosure of interest by a director
This has been made mandatory and not discretionary as was there in the Companies Act of 1956. Even in case of a private company, an interested director cannot vote or take part in the discussions relating to any matter in which he is interested.

Investments by a company
A company, unless otherwise prescribed, shall not make investments through more than two layers of investment companies subject to certain exemptions.
Related party transactions
No approval of Central Government is required for entering into any related party transactions. No approval of Central government is required for appointment of any director, or any other person to any office or place of profit in the company or its subsidiary. Certain new related party transactions are provided in the bill, which requires approval of the Board. The bill provides for certain new matters which are to be transacted by the directors at their board meetings only.

Insider trading
The Act already had a provision relating to prohibition on forward dealing in securities of the company by a director or key management personnel. The bill now provides the provisions for prohibiting insider trading in the company. All these provisions are aimed at strengthening the supervision mechanism of the company by the regulators, strengthening the powers of the board especially the IDs and above all prohibiting fraudulent transactions with related parties for which the board is made responsible.

3.8.9 Appointment and Remuneration of Managerial Personnel
The appointment and remuneration of managerial personnel is explained below.

Managing director/whole time director/manager
These appointments have to be approved by a General Meeting by special resolution instead of ordinary resolution. The bill provides for provision related to secretarial audit in certain prescribed companies and also prescribes the functions of the company secretary. This ensures greater involvement of shareholders in key appointments on the board and management.

3.8.10 Inspection, inquiry and investigation
Central government will set up a Serious Fraud Investigation Office (SFIO) for investigation of frauds relating to a company. The affairs of a related company can also be investigated by the inspector. If a fraud is reported central government is empowered to file an application to the tribunal for appropriate disgorgement of such assets, property or cash and for holding of such director, key management personnel, officer or other person liable personally without any limitation of liability. SIFO however can act if and when someone has lodged a complaint or someone has initiated an enquiry.

3.9 Corporate Governance Rating
Rating of practices of corporate governance and value creation for its stakeholders is being carried out by leading rating agencies like CRISIL. This type of rating helps the companies greatly as an unbiased evaluation of the company’s corporate governance practices is carried out by an outside and reputed agency and an appropriate rating certificate is given. The company can use this certificate for raising finance from the market as well as from foreign investors. This results in greater resources and better resource allocation and enhanced investor confidence in the company leading to better valuation. The basis for rating a company for its corporate governance practices is the company’s compliance with SEBI Clause 49 of the listing agreement with the stock exchanges and also the manner in which the various norms are fulfilled.
Summary

- Asian economies as a group share certain common features that affect the governance practices in the region.
- In terms of corporate laws and financial regulations, India has emerged far better than other East Asian countries.
- The Companies Act 1956 has been the foundation of Corporate Governance and Accounting Systems in India.
- The single most important development has been the establishment of Securities and Exchange Board of India (SEBI) in 1992.
- The process of restructuring of the corporate governance framework and development of a code of corporate governance was initiated by CII in 1996.
- SEBI has amended the listing agreement to include the above recommendations.
- The Companies Act, 1956 provides the legal framework for corporate entities in India.
- On October 23, 2008, the Minister for Corporate Affairs introduced the new Companies Bill, 2008 into the parliament.
- The Parliamentary Committee had also made a large number of recommendations in its report.
- The bill governs the issue of all types of securities.
- The annual returns of the company have been elaborated to include additional information like particulars of its holdings and subsidiary and associate companies.
- Balance sheet and profit and loss account have been defined collectively as financial statements.
- The bill provides for compulsory rotation of individual auditors every five years and of audit firm every ten years for listed and certain other class of companies.
- Section IV of the bill lays down the code which sets out the role functions and duties of the IDs and also those relating to their appointment, resignation and evaluation.
- Central government will set up a Serious Fraud Investigation Office (SFIO) for investigation of frauds relating to a company.
- The company can use this certificate for raising finance from the market as well as from foreign investors.

References

- Corporate Governance. [Video online] Available at: <http://www.youtube.com/watch?v=dx7PEKe7wJA> [Accessed 28 January 2014].
Recommended Reading


**Self Assessment**

1. In terms of corporate laws and financial regulations, ________ has emerged far better than other East Asian countries.
   a. UK
   b. India
   c. USA
   d. Bhutan

2. When was the process of restructuring of the corporate governance framework and development of a code of corporate governance initiated?
   a. It was initiated by CII in 1996.
   b. It was initiated by ID in 2000.
   c. It was initiated by SEBI in 1945.
   d. It was initiated by SEBI in 1947.

3. Match the following

<table>
<thead>
<tr>
<th>1. Audit committee</th>
<th>A. This has been made mandatory and not discretionary as was there in the Companies Act of 1956.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Vigilance mechanism</td>
<td>B. This shall now comprise of three minimum directors, majority of them being Independent Directors.</td>
</tr>
<tr>
<td>3. Disclosure of interest by a director</td>
<td>C. No approval of Central Government is required for entering into this.</td>
</tr>
<tr>
<td>4. Related party transactions</td>
<td>D. Every listed company and such other class of companies shall have this in the prescribed manner.</td>
</tr>
</tbody>
</table>

   a. 1-C, 2-A, 3-D, 4-B
   b. 1-B, 2-D, 3-A, 4-C
   c. 1-A, 2-B, 3-C, 4-D
   d. 1-D, 2-C, 3-B, 4-A

4. The code was accepted in 2000 by ________ and incorporated into a new clause 49, which was inserted into the listing agreement of companies with their stock exchanges.
   a. ID
   b. CII
   c. SEBI
   d. SE

5. When did SEBI publish a revised clause 49, relating to corporate governance, which set forth a schedule for newly listed companies and those already listed to comply with the revisions?
   a. In October 2004
   b. In July 2000
   c. In April 2007
   d. In December 2002
6. Which of the following statement is false?
   a. Businesses should conduct and govern themselves with ethics, transparency and accountability.
   b. Businesses should not promote the wellbeing of all employees only few.
   c. Businesses should respect and promote human rights.
   d. Businesses should support inclusive growth and equitable development.

7. Which act provides the legal framework for corporate entities in India?
   a. The Governance Act, 1947
   b. The Business Act, 1976
   c. The SE Act, 1965
   d. The Companies Act, 1956

8. On October 23, 2008, the Minister for Corporate Affairs introduced the new Companies __________, 2008 into the parliament.
   a. Manager
   b. Bill
   c. Act
   d. Report

9. Under which Act, only shares and debentures were covered?
   a. The Governance Act, 1947
   b. The Business Act, 1976
   c. The SE Act, 1965
   d. The Companies Act, 1956

10. Which of the following statement is true?
    a. The affairs of a company can also be investigated by the manager.
    b. The affairs of concern governance can also be investigated by the director.
    c. The affairs of a related company can also be investigated by the inspector.
    d. The affairs of governance can also be investigated by the ID.
Chapter IV
Drivers for Corporate Governance and Resisters to Corporate Governance

Aim
The aim of this chapter is to:

• introduce drivers for corporate governance and resisters to corporate governance
• explain external drivers
• explicate key resistors of corporate governance

Objectives
The objectives of this chapter are to:

• explain other issues driving corporate governance
• elucidate whistle-blowing
• explicate the present balance of forces in corporate governance

Learning outcome
At the end of this chapter, you will be able to:

• identify distrust/mistrust
• understand the value of corporate governance
• define whistle-blower
4.1 Introduction

The key underlying driver of corporate governance is the need for external funding. An organisation has to attract and retain shareholders and obtain loan finance to meet funding peaks. To be attractive to investors it has to demonstrate that funds will not be wasted, but will be used responsibly to produce consistent returns for investors. Corporate governance is the substance behind such a demonstration of effectiveness and it needs to create and harness power to achieve that end.

Business is driven by the exercise of power; corporate governance is driven by the need to moderate and channel that power. Power, like its analogue electricity, is both useful and dangerous. Wikipedia defines power as ‘a measure of a person’s ability to control the environment around them, including the behaviour of other persons … the exercise of power seems endemic to humans as social beings’. J K Galbraith classified power as ‘condign’ (based on force), ‘compensatory’ (through the use of various resources) and ‘conditioned’ (the result of persuasion), and the source of power as ‘personality’ (individuals), ‘property’ (material resources) and ‘organisational’ (hierarchical). Michel Foucault, the French philosopher, links power with knowledge, hence the power of doctors and priests. More recent thinking on power, e.g., Steven Lukes, focuses on the enabling nature of power, leading to empowerment. This is the key means of moderating and channelling power, and avoiding the concentration of power which makes effective corporate governance impossible, and unleashes the excesses of domineering leaders like Jean-Marie Messier, former CEO of Vivendi. As Lord Acton warned, all power tends to corrupt; absolute power corrupts absolutely."

If domineering leaders can destroy shareholder value for their investors, as in the case of Marconi, are entrepreneurs, who often risk their own resources, a better model for the exercise of power? Entrepreneurs are often motivated by the need to succeed, rather than by the fruits of success, as in the case of Sir Chris Evans, who has established 20 successful science-based companies, four quoted on the London Stock Exchange including Celsis and Enzymatix. Each has moved from innovation, through nurture to maturity; each needs effective corporate governance to consolidate its success. Some entrepreneurs dislike the responsibility of corporate governance; Sir Kenneth Morrison of Morrison plc fought against it, but came in line to fund his acquisition of Safeways. Others, like Sir Richard Branson, operate mainly through private companies and have limited external accountability. This is a key driver of the move to private equity structures.

Few individuals can be totally self-sufficient; most will need external support even if they are self-funding, like Boris Berezovsky and other Russian oligarchs. Sovereign Wealth Funds (SWF) are accountable only to their owner governments, most of which have created SWFs to invest windfall profits from natural resources. SWFs now total $2.2 trillion (est.), and most are located in Gulf Cooperation Council (GCC) countries, China, Singapore, Russia and Norway. Many banks have been partially recapitalised by SWFs since the sub-prime crisis and companies, such as Siemens, are seeking them as investors. Some SWFs have rigorous governance, e.g., Norway, but most are closed and do not publish details of their activities or of the motives behind their investments. Recently a code for SWFs has been developed by the IMF and many are promising to observe it. Is it real or just a smokescreen?

We can see that power is not always exercised openly and that some holders of power do not wish, or need, to be accountable other than to themselves or their closed circle. This situation is disquieting for other parties, the EU Commission is concerned about the risk of SWF takeover of strategic companies, and the USA is monitoring the situation closely. Trust in SWFs is low among OECD country governments and their emerging role as a lender/investor ‘of last resort’ is increasingly disquieting. The need for greater transparency is being pressed on SWFs, particularly when major banks and investment operations are subject to increasing scrutiny to block flows of ‘dirty money’. In his book Power and Influence (2007), Robert Dilenschneider gives copious advice on how to obtain and exercise power. His most revealing thought is ‘search for power but never forget to share it’. In a complex world of inter-dependencies, absolute power is unsustainable.
Corporate governance is the moderator of power and the channel for sharing it. Table 4.1 shows what drives corporate governance and what are the forces resisting it.

<table>
<thead>
<tr>
<th>Drivers for Corporate Governance</th>
<th>Resisters to Corporate Governance</th>
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<tbody>
<tr>
<td>Focus on the interests of the organisation</td>
<td>Self-interest, hidden agendas</td>
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<tr>
<td>Need to allocate power to get results</td>
<td>Urge to consolidate power</td>
</tr>
<tr>
<td>Need to achieve sustainability</td>
<td>Desire to have quick results</td>
</tr>
<tr>
<td>Managing risks</td>
<td>Manipulating risks</td>
</tr>
<tr>
<td>Picking ‘horses for courses’ to win</td>
<td>Protecting favourites</td>
</tr>
<tr>
<td>Deregulation/giving freedom to act</td>
<td>Regulation/control</td>
</tr>
<tr>
<td>Ensuring security of agreements</td>
<td>Ends justify the means/utilitarianism</td>
</tr>
<tr>
<td>Maintaining high standards</td>
<td>Relativism-‘what suits’/complacency</td>
</tr>
<tr>
<td>Ensuring fairness between stakeholders</td>
<td>Courting popularity for own ends</td>
</tr>
<tr>
<td>Openness</td>
<td>Secrecy</td>
</tr>
<tr>
<td>Innovation/self-renewal of the organisation</td>
<td>Resistance to change</td>
</tr>
<tr>
<td>Commitment</td>
<td>Disengagement-‘too much trouble’</td>
</tr>
<tr>
<td>Leadership from all stakeholders</td>
<td>Napoleonic leadership</td>
</tr>
<tr>
<td>Trust/reputation</td>
<td>Distrust/protectiveness</td>
</tr>
</tbody>
</table>

Table 4.1 The forces impacting on corporate governance

The pattern that emerges is of concern to protect and further the interests of the organisation, through focusing on achieving long-term sustainable results. This approach is driven by deregulation, harnessing skills and commitment and building the reputation of the organisation. The process is perpetuated through innovation and by self-renewal of the organisation’s people and resources. This total pattern is strategic in intent, harnessing key elements of corporate governance to the achievement of the purpose of the organisation. Resistance to corporate governance is founded on a repudiation of agency theory. Where employees control the operations of the organisation, which is normally the case, they fail to recognise that they are the servants of the organisation and are tempted to behave like masters. This self-serving attitude encourages hidden agendas and biases decisions in their favour. The inflation in rewards, and their divorce from business results, is an extreme symptom of this malady.

Where this malady becomes too apparent, as in scandals like Enron, Parmalat, etc., there is a grave danger of overreaction. Sarbanes-Oxley is such an overreaction which has made governance over-prescriptive and created a massive bureaucracy to police it. Self-regulation is the best approach to governance in that it engenders responsibility and allows a flexible response to situations as they develop. Self-regulation, linked to a framework of laws is a British tradition, dating back at least as far as the medieval guilds. These set standards, controlled recruitment and apprenticeship and policed behaviour. In the modern world, controlled entry is less acceptable, but much of the spirit of the guilds sustains self-regulation in a more complex world. External regulation creates conflict and expense, at its extreme it could be a return to the system of the Soviet Union.

A key driver of corporate governance is the concept of fairness. The FSA refuses to define the term but expatiates at length on the subject. The OECD defines ‘fairness’ as ‘protecting shareholder rights and ensuring contracts with resource providers are enforceable’. This implies that all shareholders have clear rights and that supply contracts are clear and even-handed. Fairness operates more widely in corporate governance, not least in stakeholder situations, and it has both legal and behavioural roots. Concepts of fairness emerged strongly in eighteenth-century philosophy, e.g., Hume, Kant and in particular Rousseau’s ‘Social Contract’. The legal roots of fairness lie in the courts of equity and have shaped jurisprudence ever since. John Rawls’ book A Theory of Justice (1971) develops the principle in detail. The behavioural aspects of fairness are developed in behavioural economics as a form of preferences (Wikipedia). In the context of corporate governance, fairness is more than equity, it is certainly not equality; it is the force which drives cooperation between stakeholders with divergent interests and resists the concentration and abuse of power.
In parallel with fairness, corporate governance is driven by trust. Trust is a relationship of reliance (Wikipedia). It is at the heart of all transactions between human beings, in particular where complete knowledge is not available. Trust is particularly important where corporate governance is based on principles, since principles require interpretation to make judgements. Rules-based corporate governance is less open to interpretation, or even to explaining precedents, yet there has to be trust in the process of shaping the rules. There is debate between social scientists on the difference between trust and confidence; some believe that trust is entirely internal and only confidence is observable. This would suggest that confidence is built on facts, and that trust is developed between people. In any case, it would seem that trust has deeper roots and can cope with greater uncertainty than confidence. One symptom of a breakdown in trust is whistle-blowing, which occurs when normal communication channels are not trusted, and which is often an act of desperation.

Another important driver of corporate governance is risk. All organisations need to identify and manage the risks they face in the knowledge that without risk there is unlikely to be meaningful reward. The Chinese use the same word for risk and opportunity. Awareness of risks is now a key dimension of corporate governance reporting, following the Turnbull Report. The recent crisis over sub-prime lending shows that understanding and managing risk is still not seen as important in organisations. It is perhaps significant that the ISO standard for risk management ISO 31000 was not published until 2009.

A document which has considerable impact is an article ‘Confessions of a Risk Manager’ in The Economist (9 August 2008). This details the structure established to manage risks and the resources devoted to the task. It shows how sentiments about risk in this bank moved from believing that it could not happen, and monitoring classic market risks, to a realisation that traders were moving into uncharted territory in pursuit of profit and creating overload in risk management. Pressure was applied through top management to approve deals with only cursory examination and any challenges from risk managers were overruled. A balance sheet of traded assets was built up whose credit ratings collapsed when marked to market. Risk management was not seen as a real function, but as a decoration to appeal to external parties, such as shareholders and auditors. Good staff went into trading; risk managers were seen as gadflies, not goalkeepers.

One of the crucial drivers of corporate governance is competition. Few organisations now enjoy a monopoly, and innovation is valuable only until competitors catch up. Where competition is imperfect, as with some utilities and financial services, regulation intervenes to simulate competition. A Strategic Approach to Corporate Governance (Davies 1999) explores in depth the contribution of effective corporate governance to achieving competitive advantage. Best Practice in Corporate Governance (Davies 2006) listed and explored the following Eight Core Dimensions of Corporate Governance:

- The identity of the organisation
- The purpose of the organisation and leadership
- The distribution of power within the organisation
- Inclusiveness, communication and the pattern of accountability required
- The maximisation of effectiveness
- Ensuring sustainability

Competitive advantage is achieved by organisations which keep these dimensions in focus and updated, aware that they have to excel in them all in order to compete successfully in the long-term. Organisations need to innovate to maintain a competitive edge; a company which has prospered through product innovation is Reckitt Benckiser. Organisations also need to adapt to change; Man Group emerged as a FTSE 100 company when it restructured to focus on derivatives trading. Competition is Darwinian in its impact; companies which do not adapt face a fate similar to British Leyland. Corporate governance needs to anticipate the impact of competition to ensure the survival of its organisation.
The key internal driver of corporate governance is leadership. In Best Practice in Corporate Governance, it is stated that, “Leadership is the driving force behind corporate governance. It maintains a firm focus on purpose and enables those involved to set each other an example in working to achieve it. Leadership is not the sole prerogative of one person, or a self-selecting group; leadership may change depending on circumstances, for example, a technical specialist may lead in a situation where patents are crucial.”

Leadership depends on trust and the competence to fulfil the role required at the time. In a crisis, leadership may have to be brought into an organisation in the form of a ‘company doctor’, in order to ride the crisis, stabilise the organisation and hand authority back to a new board. Leadership in corporate governance is not like the Berlin Philharmonic Orchestra under Herbert von Karajan, but more like an eighteenth-century chamber orchestra, with a continuo on the harpsichord, the lead passing from soloist to soloist.

4.2 External Drivers

There are a number of key external drivers of corporate governance, whose role complements or stimulates the internal drivers discussed above. Each of these operate separately, although on occasion they may operate in concert to greater effect. These external drivers are discussed below.

4.2.1 Media

All forms of media can impact on corporate governance; all do when there is a major scandal, such as BCCI. Mass media targets large audiences and will focus on corporate governance when a major story breaks, such as the crash of Barings Bank, and will rarely feature issues of corporate governance prior to a striking dénouement. Journalists love colourful characters, so that business leaders like Sir Richard Branson get regular coverage; villains like Robert Maxwell are even more interesting. Apart from such occasions, mass media does not feature issues of corporate governance.

Business and economic media, e.g., Financial Times, The Economist, etc., devote resources to the analysis of key businesses and seek the opportunity to interview key business leaders and opinion-formers (NGOs, lobby groups, business academics, etc.). As journalists, the contributors to such publications are looking for unusual ‘angles’, signs of discord on the board, difficulties with contracts, etc., which make news. They can also find weaknesses in press statements and probe to uncover the true situation, e.g., the statement that Bradford and Bingley did not need to raise new equity was rapidly belied through the media.

The role of the media in corporate governance is one of challenge. Organisations have become expert at ‘spin’, the presentation of the upside of the situation with suppression or distortion of its downside. The media is not impressed by public relations, they seek a story to interest their audience. Challenge from media is forcing greater openness on organisations and making them accountable for true situations rather than myths. This may not be the purpose of media, but it has been a powerful driver of better corporate governance, e.g., Shell’s activities in the Nigerian Delta.

4.2.2 Stakeholders

Stakeholders have emerged from the background of corporate governance to a prominent position in the foreground. The Companies Act 2006 confirms their legal status in company law and the development of corporate social responsibility widens their circle from employees, customers and suppliers to encompass other constituencies which impact on the organisation, e.g., the local community. Stakeholders drive corporate governance in varying ways and degrees, some like employees have a fundamental impact on the organisation; others, such as government, impact less directly and frequently. The stakeholders with the largest potential to drive corporate governance are shareholders. Their impact has been limited until recently, but there is a growing weight of evidence linking good governance to improved company performance, e.g., McKinsey ‘Global Proxy Watch’ 6 No. 30 (2002), and that investors are willing to pay a premium for good governance. Fuller evidence may be found in The New Capitalists (2006) by Davis, Lukomnik and Pitt-Watson. Shareholder activism is increasing as institutional investors need to produce higher returns.
Stakeholder involvement in company direction is increasing as stakeholders other than shareholders seek to benefit from the wealth-creating potential of business. NGOs and charities are laying claims to be stakeholders, buying shares to legitimise their claims. Governments have for many years exploited company wealth through taxation and harnessing companies to work for them, e.g., collecting employee taxes. It seems inevitable that stakeholders will seek to increase their benefits from association with companies through exploiting corporate governance and the greater wealth it produces.

4.2.3 Activists

All stakeholders are becoming more active but some wish to be involved in their organisations, either by having a seat on the board or by offering specialist advice. In the USA, it is almost impossible for shareholders to nominate board directors, except through expensive proxy battles, such as that waged by Robert Monks at Sears, Roebuck in 1991. Board elections are a formality. Pressure is now on to change US legislation to make board nominations and elections more democratic, e.g., from the Council of Institutional Investors. Other examples of activist board nominations are TCI’s attempts to improve governance in J-Power, a Japanese utility, which failed. TCI is one of a growing number of activist investors seeking to open up companies to improved corporate governance and, as a consequence, enhanced profits. Others are George Soros, PIRC, Knight Vinke, ADAM (France) and major pension funds such as CalPERS and Hermes. Some are descendents from the ‘corporate raiders’ of the 1960s, such as T Boone Pickens and Carl Icahn, but most are now more than opportunistic. Eric Knight of Knight Vinke claims to have forced the restructuring of Shell and is now challenging the strategy of HSBC. Colette Neuville of ADAM challenged the corporate governance of EADS and has joined the board of Eurotunnel. PIRC is very critical of the lack of openness of fund managers to independent scrutiny; it does not place directors on boards to protect investments, but is a specialist adviser.

The specialist adviser activists are spearheaded by major fund managers, such as CalPERS. Their approach is based on broad analysis to find companies which will benefit from improved management and to work with boards to have their ideas implemented. The method has a low profile and is backed by shareholding. Credit for success usually goes to management, but the adviser has an improved investment.

The impact of activists is increasingly being felt and some, like PIRC, are using their experience to intervene in the minutiae of governance, e.g., the management of general meetings. It is in these areas of process that most progress has been made; major attempts to change strategy or structure, e.g., Carl Icahn’s attempts to break up Time Warner, still meet entrenched resistance. More time is needed to effect major change, but developments such as the Myners Report 2001 are powerful signposts to progressive change.

4.2.4 Regulations

Where there is a high degree of trust, regulation is watchful but inactive. In the real world, regulators find themselves acting as referees to ensure fair play between competitors. When do regulators become drivers of corporate governance? Usually regulators show their teeth after a crisis or a scandal; the UK Pensions Regulator was established in the wake of the collapse of company pension schemes in the 1990 recession. Regulation appeals to bureaucrats and is usually self-perpetuating. The 2005 Hampton Review of the UK regulatory system sought better regulation based on a risk-based approach and proportionality in enforcement, rather than the ‘blanket’ model of regulation in force earlier. Regulators are now expected to work with clients and avoid disruption of their activities. They now report to the Department for Business, Innovation and Skills (BISS). The 2007 Regulators’ Compliance Code should encourage companies to drive for better compliance voluntarily, leaving the regulator to act as a coach rather than a policeman.

A new book by Howard Davies and David Green, Global Financial Regulation (2008), turns the attention of regulators to the need to update international regulation, which is piecemeal at present (with the EU a bureaucratic player) and focused on old models, rather than hedge funds and private equity. With the growth of multinational companies, regulation is fragmented across different regimes and it is now common for operations to be located in low-regulation countries (following the migration of tax liabilities). This process was a major contributor to the recent financial crisis, reaction to which may facilitate moves towards better regulation.
4.3 Key Resistors of Corporate Governance

The key resistors of corporate governance are discussed below.

4.3.1 Entrenched Power

One of the strongest resistors of corporate governance is entrenched power. This may be in a family-controlled organisation, where ownership legitimises control, or it may be in a company with well-established executive directors, usually led by a powerful CEO. All too often, such a person is both chairman and CEO (this is the norm in the USA) and controls all the levers of power. Danger signals include the following:

- A non-challenging finance director.
- Complacent non-executive directors (hired by the CEO).
- Executive directors all ‘home grown’ (and compliant); entrenched auditor.
- High proportion of long service employees, but above average staff turnover.
- Low product innovation.
- Above-average reward packages for executive directors.

Such situations are difficult to remedy. They were at the heart of much of the collapse of British manufacturing in the 1980s spurred on by unions which had to be ‘bought out’ and destroyed by international competition.

4.3.2 Hidden Agendas

Enron appeared to be an exemplary company, but it was consumed by hidden agendas. The only antidote to hidden agendas is a strong culture of openness, explaining reasons for actions and documenting them in detail. Internal audit is usually seen as a protection against fraud; a good internal auditor can detect mismatches between arguments and actions. Decisions taken in the interest of the company cannot logically benefit individuals or cliques disproportionately. Hidden agendas may include insider trading, commercial espionage, favouring family or outsiders at the expense of the organisation and just plain fraud.

4.3.3 Resistance to Change

Change usually involves discomfort and few are as enthusiastic for it as ‘Pioneers for Change’, the young person’s global learning network. In his blog, John Burnside of Dundee University reminds us that ‘The Book of Changes is a classic of early Chinese literature, with the key message that change is the essence of life. He points out that ‘revolutions are few … (but) systems will continue to evolve, in businesses … that is what the real world is about’. If change is inevitable even though unsettling, it makes more sense to harness rather than resist it. Most major changes impact on organisations from outside, and few can be ignored, let alone resisted, for long before the organisation is damaged. Some key changes occur inside the organisation, such as the unexpected death of key directors or the atrophy of core assets, and inaction is no defence against these. Directors who resist change, rather than harness it for the benefit of the organisation are in clear dereliction of their duty.

4.3.4 Secrecy

The standard justification for secrecy in business is to defend competitive advantage. The growing use of ‘Commercial in Confidence’ headings on documents hints at wider motivation. Some information is legally required to be kept secret, e.g., medical records, but patterns of pay should not be secret, and they are needed in any case for recruitment. Important technical secrets can be protected by patents; lesser ones are not usually secret, but are shared on a ‘need to know’ basis. Secrecy causes mistrust between people, which hinders the smooth running of corporate governance. It is usually counterproductive. Sophocles wrote: ‘Do nothing secretly; for Time sees and hears all things and discloses all.’

One area of secrecy has been private equity, created in order to avoid public accountability. Concern has been expressed by other investors, especially over discriminatory tax relief on interest payments, so that an enquiry by Sir David Walker led to a voluntary code of conduct for the industry, Pemira, CVC and others are beginning to lift the veils of secrecy over their operations. For many years, Whitehall has used the Official Secrets Act 1911 as a
cloak to cover incompetence as much as state secrets. It is a bad model which should not be followed by business. A report from the Chartered Management Institute of the views of 1,500 managers (March 2006) found only 12 per cent cited a ‘trusting culture’ in their firm. Secrecy was seen as crushing entrepreneurial spirit in the workplace, creating suspicion and aversion to risk. As 88 per cent of British firms lack a ‘trusting culture’ the road to improving corporate governance is very stoney.

4.3.5 Distrust/Mistrust
Distrust is the spirit of the relationship between antagonists; the West distrusted the Soviet Union in the cold war. Mistrust is created by uncertainty whether another party has a hidden agenda. Distrust can be positive, as when directors challenge managers to find and test the truth, or when shareholders hold directors to account. Distrust depends on a mutual belief that both parties are ‘playing a game’. When this mutual belief breaks down, mistrust takes over. Many scandals have occurred because the distrust relationship was not working; where there is no challenge, the truth cannot be discovered in time to prevent a crisis.

In respect of the principal-agent relationship, such as between shareholders and directors, a study by Falk and Kosfeld (2004) of a large number of principal-agent pairings showed that restricting agent flexibility and offering explicit incentives for targeted outcomes was counterproductive and costly. Most principals were found to give their agents wide discretion and to achieve better results than those seeking tight control.

4.4 Other Issues Driving Corporate Governance
The other issues driving corporate governance are discussed below.

4.4.1 Cost
Many companies see corporate governance as a burden and resent the growing cost of compliance. This view has been reinforced by the funding impact of Sarbanes-Oxley and its effect on companies’ operating flexibility. Scott McNeally of Sun Microsystems sees SOX as ‘one of the most damaging buckets of sand in the gears of the market economy that were ever voted 98:0 on in Washington’. He sees the cost to major public companies as at least $5–10 million each for no benefit. A report on smaller companies underlined the higher relative cost of compliance with corporate governance rules (SEC Size Subcommittee 2005). Professor Cox of Duke University suggests that much of the real concern to reverse SOX is due to its effect of making reporting on management more transparent to directors and owners. Management is now more accountable and at a disadvantage. Pressure for reversal is also coming from US lawyers who cannot match the lower legal fees offered by European law firms.

In the UK, an article by John Leyden in The Register (Leyden 2004) claims that UK government plans to improve corporate governance will cost millions of pounds. This will be triggered by the Companies (Audit, Investigations and Community Enterprise) Act 2004, which he sees as the equivalent of SOX. Much of the cost will be upgrading IT according to Butler Group. The stated aim of the Act is ‘to improve investigators’ access to information, reduce the possibility of delay or obstruction by companies under investigation and remove a possible deterrent to individuals volunteering information’. Section 448 provides protection to ‘whistleblowers’ who provide information to assist the inspection. While it is salutary to recognise the growing cost of corporate governance, the benefits emerge in the increasing adoption of best practice in governance and in the pattern of improved business results achieved by serious practitioners.

4.4.2 Whistle-blowing
The term ‘whistle-blowing’ derives from the practice of English policemen to blow a whistle when they noticed a crime being committed. Wikipedia defines a whistle-blower thus: ‘an employee or member of an organisation, especially a business or government agency, who reports misconduct to people or entities that have the power and presumed willingness to take corrective action. The misconduct may be a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations and corruption.’ An example cited is Jeffrey Wigand who exposed the Big Tobacco misinformation scandal and the connivance of tobacco company managements.
Most whistle-blowers have suffered for their action, through dismissal (as at Enron) or by persecution, even in some cases, criminal prosecution. It may be significant that most whistle-blowers whose action is publicised seem to be women. In the UK, the Public Interest Disclosure Act 1998 provides protection for whistle-blowers who act in good faith. Protection in the USA may now be provided by The Whistleblower Protection Act 2007, even to most government employees whom the Supreme Court earlier disbarred from protection under the First Amendment of the Constitution.

Public perception of whistle-blowers changed from seeing them as ‘sneaks’ when the enormity within Enron became public knowledge. Protection for whistle-blowers outside North America and the UK is fragmentary. EU competition law does include a leniency policy, but case law to date is limited.

4.4.3 The Value of Corporate Governance

A report in The Guardian (27 February 2008) by Jill Trenor ‘Poor Governance Reduces Profits says ABI’ quotes an Association of British Insurers study which showed that companies with the best corporate governance record produced profits 18 per cent higher than those with a poor record over four years. The study covered 241 companies, and established that governance drives performance, not the reverse. The lags between poor governance and inferior performance were typically two to three years. In the case of Northern Rock, the ABI had alerted shareholders over four years about excessive executive bonuses before the business imploded.

An article by Skaife, Collins and Laford (2004) focuses on the cost of capital and how activist institutions, such as CalPERS, have been reducing the cost of capital through their work on reducing information asymmetry between shareholders and managers, and reducing agency risk. A study by Deloitte North America and the EIU, ‘In the Dark’ (2005), found that compliant companies were able to improve revenues, safeguard assets and improve efficiency with a positive impact on share price. Specific benefits cited include the following:

- Improved disclosures, leading to greater investor confidence.
- Standardisation of processes and controls, reducing costs and increasing efficiency.
- Better control over management and information systems, increasing internal security.
- Improved acquisition integration, highlighting systems incompatibilities.
- Reduced risk of loss through fraud, protecting assets and reputation.
- Enhanced market confidence and reputation management, avoiding earnings restatements and delayed announcements.

A paper for the SEC by Tefara and Peterson, ‘The True Values of Corporate Governance’ (2004), examines the cost of corporate governance but concludes that they are small by comparison with the confidence which good governance gives to investors. It sees the most effective aspects of corporate governance to be as follows:

- A strong board of directors, independent of management, but with expertise to oversee management.
- Management compensation oversight; strong corporation laws and regulations to protect the rights of shareholders.
- Extensive public disclosure requirements, both financial and non-financial; a robust independent audit function.

These aspects need to be supported by credibly strong government and market enforcement mechanisms. Given these supports, companies with the highest standards of corporate governance can expect ‘to attract investors on the most favourable terms. In short, the best public companies will continue to view strong corporate governance as an investment well worth making.’ (Tefara and Peterson 2004)

An alternative approach to evaluating corporate governance is to measure the economic value added which it produces. One such measure is Economic Value Added (EVA), developed by Stern Stewart and Co., a consulting firm. A paper entitled ‘Measuring Economic Value Added (EVA): How Corporate Governance Works for Shareholders’ (Stern Stewart and Co. 2008) shows the four-step EVA calculation which is widely used in accounting and finance. In respect of corporate governance, the key benefit is to be able to incentivise managers towards maximising returns to shareholders by treating them as a franchisee, as if owning a franchise within a larger enterprise rather than as employees.
4.4.4 Government

In the past the UK government has not sought to drive corporate governance, other than through the Companies Act and linked legislation, supported by regulatory bodies to encourage it, e.g., the FSA. The EU Action Plan on Company Law and Corporate Governance (2003) involves legislation and proposals for action to make European business more open and competitive, and the Companies (Audit, Investigations and Community Enterprise) Act 2004 gives government additional powers of access to companies whose governance may be suspect. It seems that SOX may have been a watershed between liberal and interventionist government attitudes to corporate governance. It is to be hoped that economic nationalism remains the exception in approaches to the ownership of companies, but business managers will need greater self-control than has been evident in the recent banking crisis if encroachment by governments of the ‘free market’ economy is to be resisted successfully. It is difficult to envisage any normal situation in which governments should drive corporate governance. They are not parties to a purely commercial relationship and should facilitate a sound economic environment in which businesses can flourish rather than seek to direct their policies. The situation in Russia, Venezuela and other benighted economies is no model for twenty-first-century corporate governance.

4.5 The Present Balance of Forces in Corporate Governance

Looking at the situation in many emerging countries makes it easier to appreciate the progress that has been made in OECD economies towards effective corporate governance. In most cases, owners have become more involved with their companies and have put more pressure on managers to perform. Greater openness has revealed problems which might have remained hidden in the past, and increased accountability is shown in the shortening tenure of CEOs.

Despite considerable progress since the warning from Berle and Means in The Modern Corporation and Private Property (1932), the balance of power between owners and managers still favours the latter. As business becomes more complex, the value of incumbency and access to information increases. Owners can rarely be as immersed in their company as managers, particularly when most of them are portfolio investors. Owners rely on auditors to protect their interests, and pay them to do so through the company, yet auditors may be readily ‘captured’ by managers, since they need their cooperation to function economically. The power of employees has waned in recent years, partly due to the decline in trade union membership. This has reduced pressure on managers and given them more freedom of manoeuvre.

The influence of other stakeholders remains strong; managers need customers and suppliers to function effectively, and government imposes increasing burdens on business. NGOs are becoming more active, often supported by shareholding, so that companies have been driven into corporate social responsibility programmes and charity support, even as the size of political donations has declined.

Companies need to maintain a focus on their core function of producing wealth for their owners. Successful companies manage to be socially responsible without losing concentration on their core function. A key test of ‘good’ companies is the degree of pride stakeholders have in being associated with them; that pride is not only in the company’s financial results, it is also in the style and culture which helps to produce and sustain them.
Summary

- The key underlying driver of corporate governance is the need for external funding.
- Business is driven by the exercise of power; corporate governance is driven by the need to moderate and channel that power.
- Sovereign Wealth Funds (SWF) are accountable only to their owner governments, most of which have created SWFs to invest windfall profits from natural resources.
- Resistance to corporate governance is founded on a repudiation of agency theory.
- Self-regulation, linked to a framework of laws, is a British tradition, dating back at least as far as the medieval guilds.
- A key driver of corporate governance is the concept of fairness.
- The OECD defines ‘fairness’ as ‘protecting shareholder rights and ensuring contracts with resource providers are enforceable’.
- Trust is a relationship of reliance (Wikipedia).
- Organisations need to innovate to maintain a competitive edge; a company which has prospered through product innovation is Reckitt Benckiser.
- Competition is Darwinian in its impact; companies which do not adapt face a fate similar to British Leyland.
- Stakeholders have emerged from the background of corporate governance to a prominent position in the foreground.
- One of the strongest resistors of corporate governance is entrenched power.
- The standard justification for secrecy in business is to defend competitive advantage.
- Distrust is the spirit of the relationship between antagonists; the West distrusted the Soviet Union in the cold war.

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Recommended Reading

Self Assessment

1. An organisation has to attract and retain _________ and obtain loan finance to meet funding peaks.
   a. shareholders
   b. stakeholder
   c. document
   d. media

2. Who classified power as ‘condign’ (based on force), ‘compensatory’ (through the use of various resources) and ‘conditioned’ (the result of persuasion), and the source of power as ‘personality’ (individuals), ‘property’ (material resources) and ‘organisational’ (hierarchical)?
   a. Chris Evans
   b. J K Galbraith
   c. G. Bradford
   d. Mike Bingley

3. Match the following

<table>
<thead>
<tr>
<th>1. Fairness</th>
<th>A. Dates back at least as far as the medieval guilds.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Self-regulation</td>
<td>B. It was established in the wake of the collapse of company pension schemes in the 1990 recession.</td>
</tr>
<tr>
<td>3. The specialist adviser activists</td>
<td>C. Protecting shareholder rights and ensuring contracts with resource providers are enforceable.</td>
</tr>
<tr>
<td>4. Regulator</td>
<td>D. They are spearheaded by major fund managers, such as CalPERS.</td>
</tr>
</tbody>
</table>

   a. 1-D, 2-C, 3-B, 4-A
   b. 1-B, 2-D, 3-A, 4-C
   c. 1-A, 2-B, 3-C, 4-D
   d. 1-C, 2-A, 3-D, 4-B

4. All organisations need to identify and manage the _______ they face in the knowledge that without risk there is unlikely to be meaningful reward.
   a. reports
   b. documents
   c. risks
   d. resources

5. What depends on trust and the competence to fulfil the role required at the time?
   a. Governance
   b. Document
   c. Risks
   d. Leadership
6. Which of the following statement is true?
   a. The key internal driver of corporate governance is leadership.
   b. The key external driver of corporate governance is leadership.
   c. The key internal driver of corporate governance is risk management.
   d. The key external driver of corporate governance is risk management.

7. The role of the __________ in corporate governance is one of challenge.
   a. stakeholders
   b. shareholders
   c. regulators
   d. media

8. Which of the following have emerged from the background of corporate governance to a prominent position in the foreground?
   a. Stakeholders
   b. Shareholders
   c. Media
   d. Governance

9. One of the strongest resistors of corporate governance is __________ power.
   a. media
   b. entrenched
   c. shareholder
   d. stakeholder

10. Which of the following statement is false?
    a. Enron appeared to be an exemplary company but it was consumed by hidden agendas.
    b. The standard justification for secrecy in business is to defend competitive advantage.
    c. Distrust is the spirit of the relationship between antagonists; the West distrusted the Soviet Union in the cold war.
    d. Trust is created by uncertainty whether another party has a hidden agenda.
Chapter V

Human Nature and Corporate Governance

Aim

The aim of this chapter is to:

• introduce human nature and corporate governance
• explain the long-term v. short-term
• explicate hubris

Objectives

The objectives of this chapter are to:

• explain criminality/crime
• elucidate behavioural challenges to corporate governance
• explicate fraud

Learning outcome

At the end of this chapter, you will be able to:

• identify corruption
• understand moral hazards
• define fraud and corruption
5.1 Introduction

We have reviewed and assessed the progress of corporate governance to date and recognised that it has been driven by a series of scandals which have unnerved investors and raised their expectations of return to cover perceived risk. The Cadbury Report was aimed at investors in the City of London and largely focused on reducing financial risks. The use of codes to guide corporate governance has placed great emphasis on reliable systems, with checks and controls to maintain their consistency. Codes are basically instruments for self-regulation, to avoid the stringency and cost of legally enforced rules, but rely on openness and cooperation to be effective. The effectiveness of corporate governance is primarily judged by investors, who need a mechanism to assert control over the managements who drive their business. This agency problem has continued ever since ownership and management became divided from the nineteenth century onwards. Even family companies often have an agency problem. The basic criterion for owners to use in judging the effectiveness of managers is the sustainable profitability of the company, not the observation of codes. Many scandals have in recent years involved companies with apparently exemplary corporate governance systems (Enron, Parmalat, etc.), but unable to sustain consistent profitability. The recent banking crisis occurred despite the Turnbull Report and requirements to report on risk management. The large investments made in compliance departments did not prevent the rush to maximise profits and downplay risks. It would seem that focusing on systems is insufficient to ensure effective corporate governance; the spotlight needs to fall on human behaviours.

Corporate governance can only be effective through the agency of the people involved in the organisation, and many outside it. It depends on cooperation, but is affected by the actions of individuals. Those actions are conditioned by human nature, as well as by external factors. Wikipedia defines human nature as ‘the concept that there are a set of logical characteristics, including ways of thinking, feeling and acting that all normal human beings have in common’. Earlier concepts of human nature were influenced by religion, e.g., in the concept of ‘original sin’ and the need for redemption, or by philosophy. Plato was an idealist and saw the soul as a prisoner of the body. Aristotle saw body and soul as interdependent, with man being ‘a rational animal’. Later thinkers considered human nature outside a religious framework. Some, like Locke and Rousseau, saw humans as naturally good individually, but forced to compromise in association with others. The other extreme view is that of Hobbes, who saw humans in the state of nature as being in a ‘war of all against all’ and life as ‘nasty, brutish and short’. This view is reflected in Darwinism; Darwin, however, did not see human nature as fixed, but also as subject to the forces of evolution. This view is reinforced in E O Wilson’s theory of evolutionary psychology and contrasts with Locke’s view of each newborn person having a ‘blank slate’ nature, to be filled by nurture and experience. The balance of the evidence points to human nature being affected by heredity, but evolving to cope with change and interaction with others.

Freud had a more primitively driven model of human nature or psyche. He was fixated with the impact of the ‘Oedipus Complex’ on human behaviour. The ‘Oedipus Complex’ is the battle between father and son, and the son’s carnal love of his mother, as portrayed in Sophocles’ play ‘Oedipus Rex’. Freud’s model comprises the ‘id’, the dark and primitive part of human personality; the ‘ego’, the organised parts of human personality; and the ‘super-ego’, the human conscience. At birth children are ‘id ridden’ and the ‘ego’ only separates itself from the ‘id’ through external experience. Freud saw the father figure as the ‘super-ego’ and the ‘ego/id’ as the son. The ‘Electra Complex’ is the female version of the dilemma. Only by controlling the complex can the individual mature; many never do.

The Enlightenment sought to assert human reason over religious and other beliefs, as a way to build a better world. It identified a universal core in humanity, out of which the humanist movement developed. Later thinkers have come to see human nature as evolving and relative to the species rather than immutable. As a consequence, there is speculation that the Human Genome project may facilitate the manipulation of human nature to remove ‘imperfections’. Humans may be distinguished from other animals by being both sentient and rational. This creates the phenomenon known as ‘the human condition’, the dilemma of having boundless hopes, but being limited by sickness and death. Wikipedia cites the following three paradoxes of the human condition:

- Our imaginations can take us anywhere, but our physical bodies can’t.
- We are capable of the kindest, most noble things, but we are also capable of the most horrible and terrifying things.
- Humans hope for everlasting life, but are always inventing new ways to destroy each other.
5.2 The Long-term Vs. Short-term

In the past, most human beings have had few choices. Survival has been the top priority and cooperation a tactic for each individual to exploit to this end. The instinct for self replication is a mode of survival beyond one lifetime. Maslow’s ‘Hierarchy of Needs’ (Maslow 1943) is a theory of human motivation, based on research among ‘exemplary people’ in the 1940s, which seeks to explain both long-term ambitions and short-term priorities. Maslow’s model has five levels in an ascending hierarchy as follows:

- Survival (breathing, drinking, eating, excretion and sex).
- Safety/security (body, employment, resources, morality, health and property).
- Love/belonging (friendship, intimacy, family, etc.).
- Esteem (self-esteem and esteem from others).
- Self-actualisation (beliefs, aesthetic and personal development).

The first four levels are ‘deficiency needs’ which leave the individual unsatisfied, yet provide the foundation for self-actualisation.

Not all psychologists accept Maslow’s model. The human condition is more uncertain and more subject to external threat, the role of poverty is a major factor in shaping human lives. Poverty can be measured in financial terms, but it is mainly the social implications of poverty which may impact on corporate governance through the stakeholders it engages. ‘The social aspects of poverty may include lack of access to information, education, health care or political power’ (Wikipedia). Poverty can also reduce the capacity of individuals to participate in society; too many poor people do not vote in elections or in bodies which provide their pensions. The World Bank report ‘Voices of the Poor’ (2007) identifies factors which poor people associate with their poverty. These include as follows:

- Precarious livelihoods
- Excluded locations
- Physical limitations
- Gender relationships
- Problems in social relationships
- Lack of security
- Abuse by those in power
- Disempowering institutions
- Limited capabilities
- Weak community organisations

These and other facets of poverty may affect some company stakeholders and need to be recognised in governance processes. Poor administration can increase the burden of poverty, so that maintaining the rule of law and fair dealing are fundamentally crucial. It must also be recognised that corruption and abuse of power can be relatively more damaging to the poor than to those more capable of resisting them.

Organisations can exploit poverty to achieve their purpose, e.g., Taco Bell underpaid its workers in Florida, but such exploitation is not usually sustainable in the longer term. A national boycott forced Taco Bell to improve its wages and working conditions. The negative impact of poverty on economic growth is being challenged by the World Bank and multiple NGOs and this issue of macro governance affects all organisations with an economic purpose. Wise corporate governance will work with the World Bank and major institutions to reduce world poverty, since this will further its own long-term objectives.
5.3 Hubris

The concept of ‘selfhood’ was developed by a psychoanalytic theorist, Heinz Kohut and was identified with narcissistic tendencies and grandiose ambitions in some cases. These tendencies may be latent until activated. It may be that ‘selfhood’ is a factor in the development of hubris, a form of overweening pride and arrogance. Hubris was seen as a crime in ancient Greece, often involving an insult to the gods, and inviting just retribution, ‘nemesis’. In modern usage, hubris is an extreme form of arrogance, often in the face of facts, and fulfilling the proverb ‘pride goes before a fall’. Pride has a positive form, ‘alpha pride’ which often manifests itself as self-confidence. Hubris is a form of ‘beta pride’, which involves bombastic behaviour and a high degree of detachment from reality, such as was manifested by Richard Fuld of Lehman Brothers in the company’s final agony.

An example of hubris in modern times is found in Lord Owen’s book The Hubris Syndrome: Bush, Blair and the Intoxication of Power (Owen 2007). This shows in detail the development of hubris, driven by concern to bring the First Iraq War to a successful conclusion (Bush’s father had failed to triumph in 1991). Jean-Marie Messier’s over expansion of Vivendi was driven by hubris, and it is hubris which brings nemesis to Sherman McCoy in Tom Wolfe’s novel The Bonfire of the Vanities (1987), which reveals the consuming ambition of a New York ‘master of the universe’. All characters in the novel are based on actual high-profile players in the New York scene.

The City of London is also home to hubris. A key example is the demise of the powerful investment bank S G Warburg, which had a full range of services and increasing profits in the early 1990s, and seemed totally viable. In 1994 its CEO, Lord Cairns, decided to approach Morgan Stanley to negotiate a merger, without consultation within the bank. When rumours of the merger emerged resistance within the bank grew and John Mack of Morgan Stanley withdrew from talks. Key teams left Warburg and Cairns was forced to resign. Warburg’s residue was sold to UBS. A more recent example emerges from research by Tarun Ramadorai, of Said Business School, into hedge funds (2007). He found complete indifference to creating value, and a world where only 20 per cent of the players had talent. Many saw their fund as a machine to make them wealthy and had strategies which were ‘easily replicable’. Most of the funds did not even have credit insurance. The author found some ‘genuinely smart investors’ but felt that ‘caveat emptor’ was the rule in approaching the hedge fund sector. A Times Online article (29 March 2008), ‘How Hubris Shut Willie Walsh’s Eyes to Heathrow Catastrophe’, reports an interview in which Walsh brushed aside talk of long delays and lost luggage and saw Terminal 5 as a fresh start to ‘sort those issues out’. Within hours he was engulfed in a major PR disaster. Not all concentration of power leads to hubris. Warren Buffet has accumulated enormous economic power over time, but has consistently avoided hubris to date.

5.4 Criminality/Crime

In the 1960s a study of the newly found extra ‘Y’ chromosome in some males concluded that this was a ‘criminal gene’. Further research has disproved any link between X-Y-Y males and an above average incidence of criminal behaviour, according to an article in Los Angeles News (15 May 2007). Criminality is defined in the Free Dictionary as follows:

- The state, quality or fact of being criminal
- A criminal practice or act

If crime is not genetically driven, what drives it? ‘Natural law theory distinguishes between “criminality” which is derived from human nature and “illegality” which is derived from the interest of those in power’ (Wikipedia). Adam Smith cites the example of a smuggler who would be an excellent citizen except that his profession has been criminalised by the government. Criminality is seen as ‘malum in se’ (inherently criminal), whereas illegality is ‘malum prohibitum’ (decree to be criminal by the law of the country). This theory produces the paradox of acts being illegal which are no crime and of criminal acts not made illegal. As a result, natural law is less influential today in thinking about crime.

Crime is seen today as a deviation from the orderly behaviour needed to make society function. This orderly behaviour comprises cultural standards and operates within a framework of laws. Those whose behaviour is not orderly are likely to be criminalised, i.e., identified as deviant, and subject to punishment. The concept of a ‘criminal nature’ has been replaced by a focus on the nurture which has shaped the individual concerned. Some may have
been brought up in families with a criminal tradition, e.g., the Mafia, or have turned to crime in order to survive. In a business context, the ‘nurture’ may come from peer pressure to make money, driving individuals to cut corners in order to achieve success. There seems to be little evidence of inherent wickedness in human beings, despite the doctrine of ‘original sin’. Shakespeare’s Richard III turned to wickedness as his disfigurement precluded success as a lover. The human nature with which corporate governance has to contend is largely a product of nurture and thus, in theory, capable of amendment.

Human nature does not always show deviance through criminality. Often people become deviant by attacking themselves, in measures varying from self-hatred to suicide. The impact of such behaviour is often difficult to discern but some behaviours can have a significant impact on personal performance, and thus on the operation of a business. Two clear patterns of deviance are alcoholism and drug taking. The US Federal Government estimates that 8.9 per cent of full-time workers (12.7 million people) have drinking problems. This problem costs American business an estimated $134 billion annually in productivity losses, due to missed work, illness, premature death and crime. The losses to society are overall much higher. According to German Biopharmaceutical Company Merck Serono (quoted on Alcoweb) the prevalence of alcoholism in business varies from 1 to 15 per cent, depending on sector. It affects all socio-professional classes, but more physical activities (forges, foundries, construction, dockers, agricultural, etc.) are at higher risk of alcoholism. Professions with a close relationship with the public (craftsmen, representatives, café owners, postmen, police, medical, journalists, etc.) have the greatest tendency to take alcohol in a professional context.

Drug taking is also a problem for business. According to HRM Guide (8 January 2004) 25 per cent of drug users in the UK seeking help are in full-time employment. On average 15 million working days per annum are lost as a result of drug and alcohol abuse in the UK. Where controlled drugs are involved, employers risk guilt by association with their drug taking employee. Employers need well-structured procedures to deal with drug taking and alcohol abuse. Online small business resource provider Allbusiness.com cites five categories of drug testing:

- Applicant testing (the most common).
- Random testing (frequently used for safety and security related jobs).
- Post-accident testing (to determine whether drugs were involved in causation).
- Scheduled testing (during routine physical examinations).
- Treatment related testing (to monitor an employee’s efforts to remain drug free after treatment referral).

Applicants and employees should be informed in advance that drug testing is a standard procedure in the company; it is advisable that they should agree in writing to testing, and all tests need to be made by a reputable and independent laboratory. Company policy should encourage employees with substance or alcohol problems to seek assistance, on the understanding that the company prefers to support their rehabilitation if they cooperate.

### 5.5 Behavioural Challenges to Corporate Governance

The behavioural challenges to corporate governance fall into two main groupings: business offers potential opportunities for criminal activity and mismanagement opens doors to bad practice. Examples within the first grouping include fraud, embezzlement, insider dealing and money laundering. The second grouping includes misreporting, moral hazard and teleopathy. Between the two lies corruption.

#### 5.5.1 Fraud

Fraud is the principal fear of company directors and a main target of audit. It may be defined as a deception for personal gain or to damage another person or organisation. The UK Fraud Authority estimates the annual cost of fraud to be £30 billion/year. Fraud is not only financial, but affects ‘discoveries’ in science, art, archaeology and other realms of human endeavour. Many frauds are perpetuated on a small-scale, such as false insurance claims and welfare claims, and the perpetrators see their action as ‘victimless’. This is both hypocritical and incorrect, all fraud leaves someone as a loser and the costs are often passed on to the general public.
What motivates fraud? In some cases the fraud is committed to help the reputation of the fraudster with his/her peer group; examples of this are the famous scientific hoaxes Piltdown Man and repeated claims to have achieved atomic fusion, particularly cold fusion, which have been discredited. Fraud may be committed to avoid immigration control, using forged documents. Most frauds, however, have a financial objective, even confidence tricks, such as Ponzi schemes. In a business the target of most fraud is its assets, principally cash or physical assets. Fraud may be committed by insiders, e.g., accountants or salesmen, or by outsiders using computer hacking, impersonation of officers and other means. Some frauds are committed, not for profit, but to damage a person or organisation. Some of the rumours which circulate in the City of London have this purpose, as do extreme versions of office politics.

Most City frauds are intended to make money or to achieve a key business objective. One of the most famous is the ‘concert party’ organised by Ernest Saunders of Guinness to inflate Guinness share prices massively in order to take over Scottish drinks company Distillers. This might have succeeded but for a plea bargain struck by Ivan Boesky, who was involved at the New York end of the operation and had been charged on another matter. His admission was passed to the DTI in London and led to the indictment of members of the ‘concert party’ after the takeover was achieved for £2.7 billion. Part of the shame of this episode was a broken promise to retain the Distillers HQ in Scotland. The Fraud Act 2006 consolidates legislation in respect of fraud, and updates definitions of fraud.

5.5.2 Insider Dealing

Insider dealing is a form of cheating which has now been criminalised in the UK. It has been practised since stock markets began, and is still legal in many countries. The growing number of deals concluded worldwide involves increasing numbers of lawyers and other specialists, many of whom are tempted to turn their inside knowledge into personal profit. Most major stock markets now have rules to ban insider dealing but these rules have been largely ignored to date. A 2007 study by the FSA estimates that 25 per cent of takeovers in 2005 were preceded by suspicious trading activity despite the powers the FSA has had to prosecute offenders since 2001. A sample of eight takeovers was subjected to detailed examination and all parties involved were interviewed, but without result. The FSA is sensitive following the humiliating failure of its prosecution of Paul ‘The Plumber’ Davidson for market abuse in 2006.

Another case involving the FSA is the action against ‘Financial Times’ by Collins Stewart Tullett (CST) to repudiate alleged insider dealing. The FT source was a former CST employee, James Middlewick, who was suing CST for unfair dismissal. The FSA decided to take no action against CST. A major row was created by sales of EADS shares by Lagardère and Daimler ahead of the announcement of delays in building the A380 plane. Both sold 7.5 per cent of their holding in EADS, but deny collusion or insider dealing. The case continues. Proof of guilt in insider dealing is extremely difficult as it requires a clear audit trail (rarely found) or a helpful witness (as with Boesky cited above).

5.5.3 Money Laundering

Money laundering encompasses any action to create value out of an illegal action. This is no longer limited to financial transactions related to organised crime, but now includes tax evasion, false accounting and illegal funds transfer. The process of money laundering typically has three stages: placement (or initial entry of funds); layering (transactions to hide the link between the initial entry point and the point of exit) and integration (returning the funds to the legitimate economy). The term ‘money laundering’ was first used by The Guardian newspaper in respect of transfers of illegal election campaign contributions for Richard Nixon.

Money laundering is used on a global scale for drugs and other illegal transactions and for feeding corruption networks. The total annual flows of ‘dirty money’ may exceed $1 trillion worldwide (Baker 2008). Operations on this scale must involve the banking system and increasing efforts are being made, involving most banks, to curtail them. Since 1997 an Anti-Money Laundering Network has been active internationally training and supporting organisations to counter money laundering activities. There is also a Society of Anti-Money Laundering Professionals to improve education and disseminate best practice. Most OECD countries have legislation to prevent money laundering. In the USA, most interventions are spearheaded by the Patriot Act 2001; in the UK earlier legislation is consolidated in the Proceeds of Crime Act 2002. The Act makes it a criminal offence ‘for anyone to be involved in arrangements which they suspect may facilitate (in any way) someone else in acquiring, retaining, using or controlling the proceeds of crime’. It is also a criminal offence ‘for anyone who works in a regulated financial firm not to report any dealing that
they suspect, or ought to suspect, involves the proceeds of crime’. Each such firm must have a Money Laundering Reporting Officer who liaises with the National Criminal Intelligence Service. Identifying suspect dealings in a flow of legitimate transactions is a challenge which is causing some stress at operating level in financial firms, not least for fear of litigation.

5.5.4 Corruption
The Oxford English Dictionary defines corruption as ‘perversion of a person’s integrity in the performance of duty or work by bribery, etc.’ Corruption occurs mainly as institutional corruption (within an organisation) or as political corruption (within the political system). It occurs whenever a person holding office can be influenced to use that office for personal gain and/or the personal gain of a third party. The actual range of corruption is much wider, involving actions to distort the outcomes of betting, manipulating elections, professionals covering up for incompetent colleagues, and much more. Corruption affects all societies and in some it is almost endemic. Transparency International, a global civil society activist organisation, assesses perceptions of corruption in each country in the world. Their scores are based on the perceptions of a sample of business people and analysts and range from 10 (highly clean) to 0 (highly corrupt). Denmark leads the 2007 ranking with 9.4; Somalia scores 1.4.

Corruption involves people, even though systems and organisations may be corrupted. The motives for corruption are mainly personal, more money, prestige or a benefit, e.g., evading taxes. A special area of corruption is ‘noble cause’ corruption, where the motive is to act for a cause believed to be moral but where the act itself is corrupt, e.g., falsifying reports to protect a colleague. Stanford Encyclopedia of Philosophy, in its article ‘Corruption’ (14 September 2005), explores the range of types of corruption in depth and concludes: ‘In the light of the diverse range of corrupt actions, and the generic nature of the concept of corruption, it is unlikely that any precise and detailed definition of institutional corruption is possible’. This does not even analyse ‘political corruption’, which is the main driver of the Transparency International survey.

Steven Hiett’s book, A Game as Old as Empire (2007), penetrates into the ‘secret world of economic hit men to explore the web of global corruption’. His ‘economic hit men’ act as intermediaries in channelling funds from the World Bank and other sources of foreign aid into the coffers of large corporations and families who control resource-rich economies. Many of these also operate as intermediaries between companies which wish to secure contracts in such economies. Attitudes to corruption vary between countries and between individuals. In countries where wages are low and officials control access to key services, it is frequently the norm to expect a bribe for such services. The norm survives and grows as it reduces pressure to raise wages and creates job loyalty to protect useful franchises. ‘Dash’ seems to be a requirement for almost every human contact in Nigeria; on a larger scale India’s ‘licence Raj’ created millionaires. For each person who is enriched, thousands remain condemned to poverty.

Corruption not only has criminal implications; it can create a mindset that condones or encourages bad practices which corrupt the workings of an organisation. Such practices include malingering, making private phone calls, pilfering stationery, cheating on expenses, etc. Most of these activities are below the radar screen of fraud detection and their damage is more to morale than to company profits. Some of these activities are technically embezzlement, dishonestly appropriating assets held in trust and fairly simple controls, e.g., separation of duties, will help to keep them in check. There are other sources of temptation, though, which can affect good corporate governance, a selection is examined below.

5.5.5 Moral Hazard
Moral hazard occurs when a person or organisation does not bear the full consequences of their actions, due to asymmetric availability of information and consequently of risk exposure. Many examples occur in insurance where the insured is likely to be more aware of true risks than the insurer and can be tempted into negligence, knowing that his risk is insured. Moral hazard can affect principal-agent relationships, where the agent can be negligent or corrupt and impose the cost onto his principal. The recent sub-prime mortgage crisis was, in part, fuelled by moral hazard in that lenders had access to cheap money and were desperate to write new business, in spite of the increasingly low quality of their mortgages. A classical case of moral hazard was the incentives given to salesmen of Atlantic Computers Limited, which paid a bonus on sales not profits. When Atlantic was bought by British and Commonwealth Holdings plc in 1988 it became slowly apparent that sales returns were diluting profits disastrously and Atlantic was put into receivership. The bonuses had been paid and were not recoverable.
Moral hazard can occur when managers are protected from the consequences of their actions. This may occur due to nepotism, or to onerous employment contracts. It can occur when job descriptions are unclear or accountabilities are not predetermined. The operation of moral hazard and its lack of accountability can be very damaging to staff morale and corrosive of interpersonal trust.

5.5.6 Misreporting

Despite company legislation and listing rules for quoted companies, misreporting continues to affect judgement of organisations’ health and prospects. Companies may misreport to reduce taxes, or they may seek to hide a delicate financial situation; some companies inflate their reporting to strengthen share values or obtain better access to finance. A detailed paper by Oren Bar-Gill and Lucian Ayre Bebchuk (2003) demonstrates the effect of misreporting in the misallocation of funds between companies and consequent economic loss. The effect of financial restatements following misreporting on bank loan terms is shown in an NBER by Graham Si and Jiaping (2007). The issue of misreporting came to a head with the publication of Terry Smith’s book Accounting for Growth (1992). In the recession occurring at that time questions were being asked about the demise of apparently healthy companies, like Polly Peck, BCCI, British and Commonwealth and many others. Smith understood that ‘creative accounting’ had drawn a cloak over the true situation in many companies and he undertook an analysis of several companies’ accounts, identifying a range of techniques used to sanitise them. The techniques featured and analysed are:

- Acquisition and disposal (pre-acquisition write down; deferred consideration)
- Extraordinary and exceptional items
- Off balance sheet finance
- Contingent liabilities
- Capitalisation of costs
- Brand accounting
- Changes in depreciation policy
- Convertibles with part options and with auction market preferred stock
- Pension fund accounting
- Currency mismatching

Misreporting is still occurring despite an extended GAAP and now IFRS regimes for financial reporting. The requirement for directors to certify that an organisation is a ‘going concern’ is beginning to have more credibility now that Sarbanes Oxley has introduced criminal penalties for mis-certification in the USA. In the UK success in suing directors for misreporting has been limited, as in the case of Equitable Life.

Misreporting is very insidious and the intent behind it is not usually criminal. It reflects the human wish to appear sound and successful, and it does not always involve manipulating the accounts. The fashion for CSR reporting which has grown in recent years offers a good opportunity for misreporting, not that the content of CSR reports is necessarily incorrect. The PR gloss on many such reports may give a misleading impression of the company’s priorities and can be as much of a camouflage as the accounting tricks exposed by Terry Smith.

5.5.7 Teleopathy

Teleopathy is a term used by Kenneth Goodpaster to describe the mindset which pursues purpose without consideration of consequences. The ‘Killing Fields’ of Cambodia were the result of excessive teleopathy; in business the setting of targets for sales or profits is often accompanied by promises of rich rewards or dismissal. When people are driven to pursue one purpose to the exclusion of everything else it is psychologically damaging; behaviours may become irrational and at the extreme, resemble the mass hysteria attributed to lemmings.

In his book Conscience and Corporate Culture (2008), Kenneth Goodpaster attempts to bridge the gap between ethics and management. Ethics is seen as a process of cogent reasoning to discover the ‘right’, while management was focused on taking action. Goodpaster suggests that both disciplines need each other in order to produce rational solutions and sound behaviours. Teleopathy is seen as a pathology which both undermines our humanity and
threatens the social interaction on which civil society is built. Religious fanaticism is an outcome of teleopathy; Goodpaster also cites the Space Shuttle Challenger disaster and how it could have been prevented. He relates this to the relationship between investment banker Martin Siegel and Ivan Boesky, in which ambition drove Siegel to feed Boesky with inside information. It was his close relationship with Jeff Skilling which drove Andrew Fastow of Enron deeper into criminality. Teleopathy affects individuals, but it normally requires driving relationships, or in the case of Challenger fear of ‘letting the side down’, which leads to irrational behaviour. It is no consolation that lemmings do not actually behave irrationally; they are not seeking to commit suicide, but are migrating to find more space.

In contract with a generally positive view of Jack Welch’s leadership, an article by Philip M Thompson in Review of Business (1 January 2004) offers a severe critique of Jack Welch’s model of business leadership. Thompson finds that his approach was excessively focused on immediate business objectives, and ‘prevented him from leading through a broader and more humane moral horizon’. Thompson contrasts Welch’s leadership ‘with the more comprehensive and compelling moral vision of Catholic social thought’ which sees Welch’s model as inappropriate for use by current business leaders. Welch’s successor, Jeff Immelt, has a different approach to management and seems to have the ‘humane moral horizon’ seen to be lacking in his predecessor. Welch’s teleopathic focus on growth built a giant empire; perhaps Jeff Immelt will have the vision to make it sustainable.

5.5.8 Bullying

Bullying is a manifestation of power, but also often of impotence. The Andrea Adams Trust, a charity specialising in workplace bullying, defines it as ‘an abuse of power or position. It is offensive discrimination through persistent, vindictive, cruel or humiliating attempts to undermine, criticise, condemn, and to hurt or humiliate one individual or group of employees’. The Trust reports that ‘as many as 18.9 million working days are lost to bullying’ each year, and ‘up to half of all stress-related illnesses are a direct result of bullying’. Bullying can even lead to suicide, and there seems to be a correlation between being bullied at school and at work. Dr Marilyn Aitkenhead, an occupational psychologist, identifies two main types of bullying behaviour in the workplace. The first, ‘humiliating manipulation’, is often practised by charismatic individuals who are intent on success even at the price of human empathy and are charming to their seniors but expert in secretly undermining colleagues to their own advantage. The second type is ‘perfectionist anxiety’ shown by managers driven by stresses at work to place intense pressure on colleagues and subordinates and criticise any outcome less than perfect in their eyes. Only 1 in 10 bullies, in her view, are pathologically manipulative; the others can all be taught to exercise power responsibly.

A landmark case in bullying was that of Helen Green, a City administrator in Deutsche Bank, who was bullied over four years by four women colleagues and one male colleague and driven to a nervous breakdown. In desperation, she took her employer to court and won £817,000 in compensation. This verdict may help to alert employers to the damage to morale caused by bullying in the workplace and the cost to them of failing to eradicate it. Such eradication is increasingly difficult when popular entertainment (e.g., Weakest Link, X Factor, The Apprentice and Big Brother) glamorises bullying and encourages vicarious enjoyment of human degradation. Such enjoyment has no place in a civilised workplace.

5.6 Conclusion

We have explored many facets of human nature and examined the dangers to which it can expose any organisation. Human beings are individuals and cooperate basically to advance their own interests. This cooperation has all the tension of the ‘prisoners’ dilemma, whether to turn ‘Queen’s evidence’ or not and can have outcomes that can strengthen or undermine it.

Cooperation between individuals is the basic building block of organisations. This cooperation depends on individuals subordinating immediate personal interest to the communal commitment to building a shared benefit of long-term value to each individual. Such a commitment requires both leadership and mutual trust. Leadership is supported by mutual trust, and its exercise reinforces mutual trust. Berle and Means warned of a growing concentration of power in the hands of managers in The Modern Corporation and Private Property (1932) and this imbalance has worsened in the last 75 years to a point where investment banks and other financial services groups, e.g., AIG, have destroyed shareholder value on an epic scale. Managers have also focused the efforts of their staff on short-term self-enrichment objectives and have encouraged a ‘dog eat dog’ set of behaviours. Mistrust is widespread in many organisations, hampering teamwork and destroying morale.
In an article in The Economist (20 September 2008), Lakshmi Mittal is quoted as measuring Arcelor Mittal against key international benchmarks. One of these is GE, which he admires for human resources, leadership and purchasing. The same article refers to GE’s hard line on corruption and insistence on equivalent ethical standards in all markets, a policy which is in tune with rising ethical standards in many countries as they seek to benefit from globalisation. GE is now working with Gulf states to share their development plans and costs. For many years, GE has focused on developing leadership, both internally and among customers and prospects, using its famous training centre at Crotonville, New York. This has helped to produce a defined culture for the company which can be deployed globally. It has also helped to develop opportunities for new business among customers who have learned this culture. Under Jeffrey Immelt, GE is now more decentralised and future focused and its challenge is to become more transnational in its top management in order to operate globally with greater empathy. Trust is strengthening internally and among investors; for example Mubadale, the Abu Dhabi sovereign fund, is now one of GE’s 10 biggest investors. Leadership is developed at all levels in GE, not solely at the top, and is focused on the longer term, not just the next bonus payment.

Trust between individuals is built on a shared positive motivation. It may be the intrinsic motivation of people with a shared hobby, or the extrinsic motivation of shared rewards in a working team. Leadership harnesses motivation to strive for a common goal. Working together to achieve such a goal enables the individuals to grow in confidence and builds the trust which binds them to a common goal. Such a process develops positive and cooperative behaviours which make the organisation good to work in, and attractive to outside stakeholders. Sustained over time such a process builds a strong corporate reputation, reinforcing recruitment and business dealings. It may also be the only way to reconcile human nature and corporate governance over the long-term.
Summary

- Codes are basically instruments for self-regulation, to avoid the stringency and cost of legally enforced rules, but rely on openness and cooperation to be effective.
- Corporate governance can only be effective through the agency of the people involved in the organisation, and many outside it.
- Wikipedia defines human nature as ‘the concept that there are a set of logical characteristics, including ways of thinking, feeling and acting that all normal human beings have in common’.
- Freud had a more primitively driven model of human nature or psyche.
- Survival has been the top priority and cooperation a tactic for each individual to exploit to this end.
- Maslow’s ‘Hierarchy of Needs’ (Maslow 1943) is a theory of human motivation, based on research among ‘exemplary people’ in the 1940s, which seeks to explain both long-term ambitions and short-term priorities.
- The concept of ‘selfhood’ was developed by a psychoanalytic theorist, Heinz Kohut and was identified with narcissistic tendencies and grandiose ambitions in some cases.
- Hubris was seen as to the gods, and inviting just retribution, ‘nemesis’.
- In the 1960s a study of the newly found extra ‘Y’ chromosome in some males concluded that this was a ‘criminal gene’.
- Fraud is the principal fear of company directors and a main target of audit.
- Insider dealing is a form of cheating which has now been criminalised in the UK.
- Money laundering encompasses any action to create value out of an illegal action.
- Corruption involves people, even though systems and organisations may be corrupted.
- Moral hazard can occur when managers are protected from the consequences of their actions.
- The fashion for CSR reporting which has grown in recent years offers a good opportunity for misreporting, not that the content of CSR reports is necessarily incorrect.
- Trust between individuals is built on a shared positive motivation.

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- OUHK - Corporate Governance - principles, policies and practices Lecture 1 (part 1.). [Video online] Available at: <http://www.youtube.com/watch?v=Gp3yqezodua0> [Accessed 28 January 2014].

Recommended Reading

- Clarke, T., and Branson, D., 2012. The SAGE Handbook of Corporate Governance. SAGE.
**Self Assessment**

1. _______ are basically instruments for self-regulation, to avoid the stringency and cost of legally enforced rules, but rely on openness and cooperation to be effective.
   a. Governance
   b. Codes
   c. Organisations
   d. Hubris

2. The _________ of corporate governance is primarily judged by investors, who need a mechanism to assert control over the managements who drive their business.
   a. effectiveness
   b. ineffectiveness
   c. code
   d. value

3. Match the following

<table>
<thead>
<tr>
<th>1. Fraud</th>
<th>A. Perversion of a person’s integrity in the performance of duty or work by bribery, etc.</th>
</tr>
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<tbody>
<tr>
<td>2. Insider dealing</td>
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<td>C. It is a form of cheating which has now been criminalised in the UK.</td>
</tr>
<tr>
<td>4. Corruption</td>
<td>D. It encompasses any action to create value out of an illegal action.</td>
</tr>
</tbody>
</table>

   a. 1-C, 2-A, 3-B, 4-D
   b. 1-B, 2-C, 3-D, 4-A
   c. 1-D, 2-B, 3-A, 4-C
   d. 1-A, 2-D, 3-C, 4-B

4. Who had a more primitively driven model of human nature or psyche?
   a. Plato
   b. Darwin
   c. Freud
   d. Aristotle

5. Who gave the theory ‘Hierarchy of Needs’ and when?
   a. Freud gave the ‘Hierarchy of Needs’ theory in 1943
   b. Aristotle gave the ‘Hierarchy of Needs’ theory in 1943
   c. Darwin gave the ‘Hierarchy of Needs’ theory in 1943
   d. Maslow gave the ‘Hierarchy of Needs’ theory in 1943
6. The concept of ‘_______’ was developed by a psychoanalytic theorist, Heinz Kohut and was identified with narcissistic tendencies and grandiose ambitions in some cases.
   a. narcissist
   b. nemesis
   c. self-love
   d. selfhood

7. Which of the following statement is true?
   a. Pride has a positive form, ‘alpha pride’, which often manifests itself as self-confidence.
   b. Power has a positive form, ‘alpha pride’, which often manifests itself as self-confidence.
   c. Selfhood has a positive form, ‘alpha pride’, which often manifests itself as self-confidence.
   d. Motive has a positive form, ‘alpha pride’, which often manifests itself as self-confidence.

8. Which of the following statement is false?
   a. In the 1960s a study of the newly found extra ‘Y’ chromosome in some males concluded that this was a ‘criminal gene’.
   b. Crime is seen today as a deviation from the orderly behaviour needed to make society function.
   c. Human nature always shows deviance through criminality.
   d. Two clear patterns of deviance are alcoholism and drug taking.

9. What may be defined as a deception for personal gain or to damage another person or organisation?
   a. Fraud
   b. Insider dealing
   c. Money laundering
   d. Corruption

10. The term ‘_________’ was first used by The Guardian newspaper in respect of transfers of illegal election campaign contributions for Richard Nixon.
    a. fraud
    b. insider dealing
    c. money laundering
    d. corruption
Chapter VI

Business Ethics

Aim
The aim of this chapter is to:

• introduce ethics
• explain evolution of ethics over the years
• explicate approaches to job design

Objectives
The objectives of this chapter are to:

• enlist characteristics of business ethics
• elucidate ethical behaviour of employees
• explain ethics and responsibilities

Learning outcome
At the end of this chapter, you will be able to:

• identify the types of ethics
• understand the factors governing business ethics
• recognise the benefits of managing ethics at the workplace
6.1 Introduction

Ethics is derived from the Greek word ‘ethos’ which means a person’s fundamental orientation towards life. Ethics refers to the moral standards used to govern behaviour and to determine right or wrong, good or bad. Ethical behaviour is the act consistent with the moral standards or codes of conduct established by society (Fernando, A., 2009). Ethical standards may change over time and differ from culture-to-culture. For example, political bribes or payoffs may be acceptable in one culture, but not in another. Ethical issues are inevitable in business.

Our country has been known as the leader in the area of ethics, values and so on for the rest of world since time immemorial. Over a period of time our own countrymen have gone away from the area of ethics, though gradually. Recently there is a rapid fall in ethics throughout the country, which again necessitates thinking over the meaning, need/significance and its practice. The Oxford English Dictionary defines “ethics as the science of morals, rules of conduct or moral principles.” It is very often used, as a synonym for terms like values, norms, standards and morality, etc. Ethics is something like electricity, not apparent to the naked eye, but felt instantaneously in certain specific conditions and also visible when power is switched on. Ethics is like a fabric of whole society and therefore a society without ethics is like a man without clothes (Stephen R. Covey, 2012). It means ethics is something which prevents nudity in any society and thus also determines the comparison of degree of nudity in any civic society. Ethics therefore is essentially required to adopt and cover wholly the whole body of bodies of any civic society. It only differentiates between a civic and barbaric action (Manuel G Velasquez, Fall 1987).

Ethics is two things

First, ethics refers to well-based standards of right and wrong that prescribe what humans ought to do, usually in terms of rights, obligations, benefits to society, fairness, or specific virtues (Michael J Meyer 1987). Ethics, for example, refers to those standards that impose the reasonable obligations to refrain from rape, stealing, murder, assault, slander, and fraud. Ethical standards also include those that enjoin virtues of honesty, compassion, and loyalty. Ethical standards include standards relating to rights, such as the right to life, the right to freedom from injury, and the right to privacy. Such standards are adequate standards of ethics because they are supported by consistent and well-founded reasons.

Secondly, ethics refers to the study and development of one’s ethical standards. As mentioned above, feelings, laws, and social norms can deviate from what is ethical. So, it is necessary to constantly examine one’s standards to ensure that they are reasonable and well-founded. Ethics also means, that the continuous effort of studying moral beliefs and moral conduct, and striving to ensure that the institutions help to shape, live up to standards that are reasonable and solidly-based. Ethics is a system of moral principles. They affect how people make decisions and lead their lives. Ethics is concerned with what is good for individuals and society and is also described as moral philosophy.

Ethics covers the following dilemmas:

• How to live a good life
• Rights and responsibilities
• The language of right and wrong
• Moral decisions-what is good and bad?

6.2 Evolution of Ethics over the Years

If we trace the history of ethics in business, we would realise that ethics had been part of theological discussions prior to 1960. Before 1970s, there were a few writers like Raymond Baumhart who dealt with ethics and business. Ethical issues were mostly discussed as part of social issues. Men of religion and theologians continued writing and teaching on ethics in business. Professors in B-schools wrote and continued to talk about Corporate Social Responsibility (CSR), the handmaid of ethics. However, the catalyst that led to the field of business ethics was the entry of several ‘philosophers, who brought ethical theory and philosophical analysis to bear on a variety of issues’
Norman Bowie dates the genesis of business ethics in November 1974, with the first conference on the subject held at the University of Kansas. In 1979, three anthologies on business ethics appeared. They were

- Ethical Theory and Businesses by Tom Beauchamp and Norman Bowie,
- Ethical Issues in Business: A Philosophical Approach by Thomas Donaldson and Patricia Werhane and

In 1982, Richard De George brought out Business Ethics while Manuel G. Velasquez published his Business Ethics: Concepts and Cases. All these books created a lot of interest on the subject and business ethics courses were offered in several management schools. The emergence of business ethics, however, was not restricted to textbooks and courses in B-schools. By 1975, business ethics became institutionalised at many levels through writings and conferences. By 1980s, the subject was taught in several universities in the United States and Europe. There were also, by this time, many journals of business ethics, apart from societies established to promote ethical practices. By the year 1990, business ethics as a management discipline was well-established. “Although the academicians from the start had sought to develop contacts with the business community, the history of the development of business ethics as a movement in business, though related to the academic developments, can be seen to have a history of its own.”

### 6.3 Approaches to Ethics

Philosophers now-a-days tend to divide ethical theories into the following three areas, such as meta ethics, normative ethics and applied ethics.

- Meta-ethics deals with the nature of moral judgement. It looks at the origins and meaning of ethical principles.
- Normative ethics is concerned with the content of moral judgements and the criteria for what is right or wrong (H Carens–1996).
- Applied ethics looks at controversial issues like war, animal rights and capital punishment and human rights.

#### Philosophers’ views on origin of ethics

Philosophers have several answers to the following questions:

- God and religion
- Human conscience and intuition
- A rational moral cost-benefit analysis of actions and their effects
- The example of good human beings
- A desire for the best for people in each unique situation
- Political power

### 6.4 Ethical Behaviour of Employees

Before venturing to discuss the ethical behaviour of the employees, one has to go into grass root level of ethics. There are various definitions to Ethics. Ethics is a set of moral rules and regulations formulated from time immemorial by the society for its members to lead an honest and happy life. For achieving the same, self-interest of the members is secondary and caring for others is primary. Ethics indicates the way of life one has to lead, where honesty, discipline and understanding of moral ideals, character and relationship with others are the influencing forces. It also cautions the members about the opposing forces to which one should not succumb. Mike Martin, in his book ‘Ethics in Engineering’ says, “Ethics is also used to refer to the particular set of beliefs, attitudes and habits that a person or group displays concerning morality.” It is the ‘discipline dealing with what is good and bad and with moral duty and obligation’ (Mollie Painter-Morland-2011).

Ethics are two types, Personal Ethics and Professional Ethics. Personal Ethics is defined as “the rules by which an individual lives his or her personal life” and Professional Ethics indicates “the moral way the professional should behave in his domain of profession, be it engineering, medical, legal or business.” Ethics in general indicates the moral choices made by each person in relationship with other persons. Great philosophers, such as Socrates and Aristotle propounded their theory of ethics based on the ancient religious thoughts that prevailed in Greece. Later, philosophers like Kant and Mill modified the base of Ethics to say that it need not stem from religion and advocated that the moral principles are universal regardless of their origin and are applicable even in secular settings.
The following moral theories help the employees to conduct themselves in various situations relating to personal and professional areas:

- Duty ethics, rights ethics and virtue ethics are important moral theories.
- Duty ethics contends that there are duties that an individual should perform, like treating others fairly or duty not to injure others.
- Rights ethics emphasises that all have moral rights and any action violating those rights is ethically unacceptable.
- Virtue ethics regards actions as right that manifest good character traits and regards actions as bad that display bad character traits called vices. This theory underscores the type of person one should be. Responsibility, honesty, competence and loyalty are considered as virtues and they are more of personal ethics. However, in using virtue ethics, it is important to ensure that the traits one identifies are really virtuous and will not lead to negative consequences.

Employees are bound to have moral problems in their personal as well as in their professional areas. Employees’ behaviour will change according to different situations. Unless they understand the ethical problems fully, their behaviour is bound to be different and consequently, no solution would be at sight.

6.5 Ethics and Responsibilities

Ethics has several attributes, some of which are universal in nature, while others are bound by time and place. It may be specific to a particular task situation, profession or area of responsibility, e.g., ethics of top executives, middle executives or junior executives in any company, ethics of a Judge, ethics of a Doctor, Teacher or a Chartered Accountant and so on. Now-a-days ethics or values are being prescribed even for organisations as a whole to carry out the activities with the sense of right and wrong, i.e., what is permissible, what is not permissible, what is to be done and what is not to be done. Certain things are expected from everyone, while there may be a few specific things expected according to the nature of groups or responsibilities. Ethics is something related to a state of mind, a way of looking at things, which may develop into a pattern of behaviour, or way of life and social conduct. One’s values may indicate or reveal one’s preferences, while norms identify social prescriptions or obligations, which have a regulatory significance (Carter, C., 2007). One should always bear in mind and have clear-cut difference in authority, responsibility and accountability. No authority can be without responsibility and accountability. Duty is the balanced mixture of authority, responsibility and accountability. Thus, every person is accountable for his good or bad decisions/deeds.

Ethics is a branch of philosophy which seeks to address questions about morality, such as what the fundamental semantic, ontological, and epistemic nature of ethics or morality is (meta-ethics), how moral values should be determined (normative ethics), how a moral outcome can be achieved in specific situations (applied ethics), how moral capacity or moral agency develops and what its nature is (moral psychology), and what moral values people actually abide by descriptive ethics (Paul, Richard; 2006).

6.6 Objectives of Ethics

The objectives of ethics are as listed below:

- The primary objectives are to define the highest good of man and set a standard for the same. Ethics deals with several interrelated and complex problems which may be of psychological, legal, commercial, philosophical, sociological and political in nature.
- The other objectives are many. These are as follows:
  - Study of human behaviour; making evaluative assessment about them as moral or immoral.
  - Establishing moral standards and norms of behaviour.
  - Making judgements upon human behaviour based on these standards/norms.
  - Prescribing moral behaviour making recommendations about how to behave or vice-versa.
  - Expressing an opinion or attitude about human conduct in general.
The objectives of ethics are shown in the Fig. 6.1 below.

**Fig. 6.1 Objectives of ethics**


### 6.7 Types of Ethics

The types of ethics are as explained in the paragraphs given below.

**Meta-ethics**

Meta-ethics is concerned primarily with the meaning of ethical judgements and/or prescriptions and with the notion of which properties, if any, are responsible for the truth or validity thereof. Meta-ethics as a discipline gained attention with G.E. Moore’s famous work *Principia Ethica* from 1903 in which Moore first addressed what he referred to as the naturalistic fallacy. Moore’s rebuttal of naturalistic ethics, his open question argument sparked an interest within the analytic branch of western philosophy to concern oneself with second order questions about ethics; specifically the semantics, epistemology and ontology of ethics.

The semantics of ethics divides naturally into descriptivism and non-descriptivism. The former position advocates the idea that prescriptive language (including ethical commands and duties) is a subdivision of descriptive language and has meaning in virtue of the same kind of properties as descriptive propositions, whereas the latter contends that ethical propositions are irreducible in the sense that their meaning cannot be explicated sufficiently in terms of truth-conditions.

Correspondingly, the epistemology of ethics divides into cognitivism and non-cognitivism, a distinction that is often perceived as equivalent to that between descriptivists and non-descriptivists. Non-cognitivism may be understood as the claim that ethical claims reach beyond the scope of human cognition or as the (weaker) claim that ethics is concerned with action rather than with knowledge. Cognitivism can then be seen as the claim that ethics is essentially concerned with judgements of the same kind as knowledge judgements; namely about matters of fact.
The ontology of ethics is concerned with the idea of value-bearing properties, i.e., the kind of things or stuffs that would correspond to or be referred to by ethical propositions. Non-descriptivists and non-cognitivists will generally tend to argue that ethics does not require a specific ontology, since ethical propositions does not refer to objects in the same way that descriptive propositions do. Such a position may sometimes be called anti-realist. Realists on the other hand are left with having to explain what kind of entities, properties or states are relevant for ethics, and why they have the normative status characteristic of ethics.

**Normative ethics**
Traditionally, normative ethics (also known as moral theory) was the study of what makes actions right and wrong. These theories offered an overarching moral principle to which one could appeal in resolving difficult moral decisions. At the turn of the 20th century, moral theories became more complex and are no longer concerned solely with rightness and wrongness, but are interested in many different kinds of moral status. During the middle of the century, the study of normative ethics declined as meta-ethics grew in prominence. This focus on meta-ethics was in part caused by an intense linguistic focus in analytic philosophy and by the popularity of logical positivism.

**Applied ethics**
Applied ethics is a discipline of philosophy that attempts to apply ethical theory to real-life situations. The discipline has many specialised fields, such as bio-ethics and business ethics. The lines of distinction between meta-ethics, normative ethics, and applied ethics are often blurry. For example, the issue of abortion can be seen as an applied ethical topic since it involves a specific type of controversial behaviour. However, it can also depend on more general normative principles, such as possible rights of self-rule and right to life, principles which are often litmus tests for determining the morality of that procedure. The issue also rests on meta-ethical issues, such as “where do rights come from?” and “what kind of beings has rights?”

After going through the above information about the different types of ethics, it is felt that some modified type of ethics can be developed for making it more effective. In understanding the types of ethics, the following figure was developed which can also be suitable for the research organisation.
6.8 Ethics in Business

In the normal sense, the term ‘Business’ includes every type of economic activity carried on by a business enterprise like manufacturing, marketing, trading, importing, exporting and providing various types of services and such activities may be conducted by an individual, a partnership firm or a limited company. However, as we are concerned with the ethical values of a modern corporate entity, it is felt that the usage of the term ‘Corporate Ethics’ will be more appropriate for our discussion rather than the term ‘Business Ethics’. When it comes to governance of companies, it is used as the term ‘Corporate Governance’ and not ‘Business Governance’.

Fig. 6.2 Modified ethics types suitable for research organisation
As the ethical values and principles are identified as core human virtues, it is expected that every member of the board and the senior management team of a corporate entity should possess and develop such virtues for the good of mankind. Unless there is complete cohesion, mutual trust and perfect understanding between the promoters (people who hold majority stake in a company), board and senior management team to carry on the business activities on ethical lines and by fair means for common good of society rather than promotion of their self-interest and personal enrichment, there will be conflicts, frictions, disagreements and disputes between them relating good corporate governance, which may come out in the open selling the good image and reputation of an organisation nurtured and built over a period of time.
In the broader sense, business ethics involves a number of complex areas of a business management and administration, such as economic systems, organisational constitution, organisational policy, business strategy based on intuition and level of existing and anticipated competition in the market place, functional operations and individual conduct of the core team, which can throw light to the level of ethical values and practices existing in a corporate enterprise and how they can be improved by pedagogy. In substance, business ethics aims at to manage all relationships, both internal and external with total commitment and integrity and with a view to ensure the long-term survival of a corporate organisation. An organisation can grow, expand and be successful, only if there is adequate disclosure of information at all levels, cross fertilisation of ideas more so with the active involvement of a knowledgeable and talented work force, transparency in business dealings resulting in shared vision and values (Peterson, Christopher: Seligman. Martin 2004).

Every corporate entity must create a good environment for creativity and excellence providing enough independence and authority to its staff at all levels, but at the same time it must establish adequate, proper, effective monitoring and control systems, so as to ensure that its business activities are properly conducted within the legal and regulatory framework. It should be recognised and appreciated that any serious violation of ethical values and principles in its functioning will not only undermine the public confidence in it, bring bad publicity, but ultimately result in strong intervention by Government and a number of regulatory bodies. No doubt on account of various pressures exercised by different sections of society, a company will always be subject to supervision and regulation of its activities as a responsible social entity on its size, behaviour, governance, accounting, legal and social compliances under various laws, rules and regulations applicable to it.

Recent global events have conclusively proved the Chief Executive Officers (CEOs) and a few other top executives exercise excessive powers and unlimited authority in the organisational hierarchy of a great majority of business organisations. Consequently, the philosophy of many corporations is not distinguishable from the personal ambitions, goals and objectives of the CEO. If the CEO is considered a charismatic leader with a strong social commitment, he will be able to gain a lot of respect and goodwill of his shareholders, employees, consumers and society at large and thereby enhancing the image and esteem of the corporate entity, which is under his control. On the other hand, if the CEO attempts to primarily focus on increasing his own personal wealth aided and abutted by an inner circle of key executives at the cost of the organisation, sooner or later he will ensure the downfall of himself as well as of the organisation in which he is serving. A recent research study published by the United Kingdom’s Institute of Business Ethics based on various criteria including ethical code of practices provides irrefutable proof and strong evidence that companies clearly committed to ethical behaviour perform financially well over the long-term than those lacking such a commitment. In the aftermath of recent corporate scandals, Business Ethics has now become a hot and popular subject for teachings and case studies in all world-renowned business schools.

**6.9 Characteristics of Business Ethics**

Every business organisation should conduct its business keeping in mind to make that the organisation should have an ethical image, through-out which will have the impact on its success not mere financial aspect but as more ethical means. World’s reputed business firms which are maintaining ethical standards are prospering with exemplary progress. Some examples are Nippon, Microsoft, Intel, Hitachi, Pepsico, Wipro, etc., Business ethics are ethics that refer to the moral rules and regulations governing the business world. In other words, they are the moral values that guide the way corporations or other business make decisions. Some business ethics are imposed by law. Business ethics is the behaviour that a business adheres to in its daily dealings with the world. The ethics of a particular business can be diverse. They apply not only to how the business interacts with the world at large, but also to their one-on-one dealings with a single customer. Good business ethics should be a part of every business. The main characteristics of business ethics are as follows:

- Business ethics constitutes the guiding principles of business functions with the help of this; businessmen can lean about the progress, situation, environment and conditions of the business.
- Business ethics is that branch of the business environment which studies about the goals and means for the rational selection of sacred objects and their fulfillment. Business ethics is concerned with the principles of business behaviour, standards, moral values, etc. With the study of business ethics, we can show the difference between good and evil, proper and improve actions of business. For these activities in business, business ethics is known as an ideal science. It is an art because it emphasises practical use of behavioural standards, techniques and principles.
Business ethics is concerned with the human aspect. It provides information to customers, government, society, etc., on good or bad, right or wrong conducts of business.

Social responsibility is concerned with functions, programmes and policies of an enterprise, whereas business ethics is related with the conduct and behaviour of businessmen. However, social responsibility of business and its policies are influenced by ethics.

The development of business ethics is possible on the basis of theological principles, such as service, human welfare, sincerity, good behaviour, etc.

Personal dignity can develop with the principles of ethics.

Business ethics is not concerned with emotions, but is based on reality and social customs. As a matter of fact, business ethics is developed after testing the requirements of business environment, social customs and traditions.

Business ethics is a universal philosophy. Ethical principles have relevance in every business.

### 6.10 Levels of Business Ethics

The levels of business ethics are as follows:

- **Societal:** At this level, questions about the basic institutions in a society are asked. The problem of apartheid and debate over the merits of capitalism are examples of such questions.
- **Stakeholders:** This level is concerned with relations between a business enterprise and its stakeholders, such as employees, customers, shareholders, government, regulators, unions, small investment groups, suppliers, etc. Insider trading is one example of such relations.
- **Internal policy:** At this level, relations between an organisation and its employees are analysed. Rights and obligations of the two towards each other are important.
- **Personal:** Here, questions about how people should treat one another within an organisation are asked. These questions deal with the day-to-day issues of life.

### 6.11 The Main Elements of Business Ethics

The main elements of business ethics are:

- **Values:** Values are the moral beliefs held by an individual, an organisation and a society. Values represent moral convictions and are relatively permanent. For example, a company may charge reasonable prices due to its value systems inspite of its monopoly position in the industry.
- **Rights:** Rights are the claims of the individual or organisation. For example, every citizen of India enjoys certain rights under the country’s constitution.
- **Duties:** Duties are the obligations of a person or an organisation. For example, every citizen has the duty to follow the country’s law.

### 6.12 Factors Governing Business Ethics

Business ethics has deep and wide roots in society. Some of the pressure points of ethical behaviour are given below.

**Value forming institutions**

The value system of an individual is shaped by various institutions, e.g., family, religion, school and the government. These institutions prescribe what is good or bad for an individual. Right behaviour is rewarded, while wrong behaviour is punished. This continues throughout the life of an individual as he acquires certain values through his daily experience in the long-run. The influences of these institutions are interrelated. The values fostered by one institution are reinforced by the others. As an organisation is an agglomeration of individuals, its values are the collective values of its members. That is why a conflict may arise between the values of the organisation and those of an individual.
Organisational goals
The objectives of an organisation influence the values of its members. A business is an economic institution and it must be profitable. The classical economic theory stressed profit maximisation goal. Many times, achieve organisational goals. However, the goal may be tempered by many values. Leadership, integrity, knowledge and skills, survival are some of them. All these factors change the goals of an organisation and consequently expected behaviour from its members.

Work and career
Work refers to the job and the tasks or responsibilities associated with it. Career, on the other hand, represents a series of jobs or positions. Each work has its own values and persons performing the work follow these values. For example, sales people may have different values than engineers. Thus, work and career create special values that give unity, cohesion and meaning to persons and groups.

Superiors
Most people succumb to pressure from superiors in doing things that they may consider unethical otherwise. For example, a secretary may tell a visitor that the boss is out, when he is actually in because her boss has told her to do so. Many a time, an employee may sign false documents due to pressure from the boss.

Peers and colleagues
An individual in a work group tends to conform to the norms of the group. He does so either to get approval or friendship of his colleagues. He adopts the attitudes, beliefs and values of the group to which he is associated. Thus, the behavioural standards of the peers and colleagues exercise a significant influence on the value system of an individual. For example, a person may justify some indiscretions on the basis that ‘everybody is doing it’.

Professional codes
These days, three types of codes are available. First, big companies formulate their philosophy or creed to guide the behaviour of their employees. The main objective of these documents is to build the company’s image by showing the company’s concern for ethical behaviour in the society. Secondly, company policies contain a code to guide actions that have an ethical conduct, example, no discrimination in recruitment on the basis of caste, creed, sex and religion. Thirdly, professional bodies have prescribed ethical codes to govern the conduct of their members. In India, the Institute of Company Secretaries of India, the All India Management Association (AIMA) etc., have formulated professional codes. These codes are enforced through fines and even expulsion of erring members. However, such sanction is not very effective in the field of management code because the AIMA does not have the statutory authority to enforce and majority of managers are not its members.

According to the business ethics survey conducted by KPMG India smart Indian companies are increasingly becoming concerned about ‘the way they do business’, they realise that ‘good ethics is good business too’. The survey suggested the following five steps to develop Ethical Corporations:

- Appoint an ethics officer preferably a respected senior executive who has recently retired from your organisation.
- Involve employees in developing a mission statement, if you already have one, recheck if you need to add ethics to it.
- Evolve a code of conduct and ensure every employee knows exactly how your company likes to conduct business.
- Facilitate upstream communication from employees by investing in a grievance cell or a hotline or an ombudsman.
- Build an ethical culture by personal example CEO should stand for chief ethics officer in your company.
Based on the above information, the factors that influence business ethics are consolidated and presented in the Fig. 6.4.

*The quality and worth of leadership can only be measured in terms of what a leader intends, values, believes in or stands for – in other words, character

* The leader has to foster learning offering choice, and building consensus

*If we pollute even a small amount, the world would be a very dirty place in which we would not like to live

Fig. 6.4 Factors influencing business ethics

6.13 Managing Ethics
Managing ethics in the workplace holds tremendous benefit for leaders and managers, benefits both moral and practical (SA Sherlekar, 2001). This is particularly true today when it is critical to understand and manage highly diverse values in the workplace. However, the field of business ethics has traditionally been the domain of philosophers, academics and social critics. Consequently, much of today’s literature about business ethics is not geared toward the practical needs of leaders and managers, the people primarily responsible for managing ethics in the workplace. The most frequent forms of business ethics literature today typically include the following:

- Philosophical, which requires extensive orientation and analysis.
- Anthologies, which require much time, review and integration.
- Case studies, which require numerous cases, and much time and analyses to synthesise.
- Focus on social responsibility, which includes many examples of good and bad actions taken by companies.

(This lack of practical information is not the fault of philosophers, academics or social critics. The problem is the outcome of insufficient involvement of leaders and managers in discussion and literature about business ethics. More leaders and managers must become involved. This guidebook aims to increase that involvement.)
Guidelines for managing ethics at the workplace

The following guidelines ensure the ethics management programme is operated in a meaningful fashion:

- Recognise that managing ethics is a process. Ethics is a matter of values and associated behaviours. Values are discerned through the process of ongoing reflection. Therefore, ethics programmes may seem more process-oriented than most management practices. Managers tend to be skeptical of process-oriented activities, and instead prefer processes focused on deliverables with measurements. However, experienced managers realise that the deliverables of standard management practices (planning, organising, motivating and controlling) are only tangible representations of very process-oriented practices. For example, the process of strategic planning is much more important than the plan produced by the process. The same is true for ethics management. Ethics programmes do produce deliverables, e.g., codes, policies and procedures, budget items, meeting minutes, authorisation forms, newsletters, etc. However, the most important aspect from an ethics management programme is the process of reflection and dialogue that produces these deliverables.

- The bottom line of an ethics programme is accomplishing preferred behaviours in the workplace. As with any management practice, the most important outcome is behaviours preferred by the organisation. The best of ethical values and intentions are relatively meaningless unless they generate fair and just behaviours in the workplace. That’s why practices that generate lists of ethical values, or codes of ethics, must also generate policies, procedures and training that translate those values to appropriate behaviours.

- The best way to handle ethical dilemmas is to avoid their occurrence in the first place. That’s why practices, such as developing codes of ethics and codes of conduct are so important. Their development sensitises employees to ethical considerations and minimise the chances of unethical behaviour occurring in the first place.

- Make ethics decisions in groups, and make decisions public, as appropriate. This usually produces better quality decisions by including diverse interests and perspectives, and increases the credibility of the decision process and outcome by reducing suspicion of unfair bias.

- Integrate ethics management culture and then design policies to produce these behaviours with other management practices. When developing the values statement during strategic planning, include ethical values preferred in the workplace. When developing personnel policies, reflect on what ethical values you’d like to be most prominent in the organisations.

- Use cross-functional teams when developing and implementing the ethics management programme. It’s vital that the organisation’s employees feel a sense of participation and ownership in the programme, if they are to adhere to its ethical values. Therefore, include employees in developing and operating the programme.

- Value forgiveness: This may sound rather religious or preachy to some, but it’s probably the most important component of any management practice. An ethics management programme may at first actually increase the number of ethical issues to be dealt with because people are more sensitive to their occurrence. Consequently, there may be more occasions to address people’s unethical behaviour. The most important ingredient for remaining ethical is trying to be ethical. Therefore, help people recognise and address their mistakes and then support them to continue to try operate ethically.

- Note that trying to operate ethically and making a few mistakes is better than not trying at all. Some organisations have become widely known as operating in a highly ethical manner, e.g., Johnson and Johnson, Intel, Hewlett Packard, Ford, etc. Unfortunately, it seems that when an organisation achieves this strong public image, it’s placed on a pedestal by some business ethics writers. All organisations are comprised of people and people are not perfect.

- However, when a mistake is made by any of these organisations, the organisation has a long way to fall. In our increasingly critical society, these organisations are accused of being hypocritical and they are soon pilloried by social critics. Consequently, some leaders may fear sticking their necks out publicly to announce an ethics management programme. This is extremely unfortunate. It’s the trying that counts and brings peace of mind, not achieving a heroic status in society.
6.14 Need for Ethics in Business

Ethical considerations are as important in management as in any other occupation. In the field of morality, personal life is not separate from business life. The social dimensions of business ethics cannot be overlooked because many problems arise from the relationship of business to the broader society. Ethical considerations are significant for managers due to the following reasons:

- For every individual, job is the centre of life. Unless job values are in harmony with the rest of life, he cannot be a happy and healthy person.
- Modern society is an industrial society. Therefore, business values become the values of the society as a whole.
- A business executive must take into consideration the moral and social considerations because these are the real motivating factors.
- When an organisation fails to behave in accordance with the social expectations, it may lose not only its image and market share, but its very right to exist.
- Today, a business manager is expected to serve as a trustee of various social groups. As the trustee, he must observe the ethical values of the society.

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<thead>
<tr>
<th>Functions</th>
<th>Ethics</th>
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<tbody>
<tr>
<td>Marketing</td>
<td>Treatment of customer complaints</td>
</tr>
<tr>
<td>Advertising</td>
<td>Trust of claims</td>
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<tr>
<td>Location</td>
<td>Impact on community and environment</td>
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<td>Production</td>
<td>Pollution treatment claims</td>
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<td>Transportation</td>
<td>Safety regulation compliance</td>
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<td>Concern for social values</td>
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<tr>
<td>Concern for social</td>
<td>Profits to re-compensate investors safeguarding assets</td>
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<tr>
<td>values</td>
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<tr>
<td>Personnel</td>
<td>Meeting promises to pay fair treatment in hiring, promotion, dismissal and pensions</td>
</tr>
<tr>
<td>Purchasing</td>
<td>Avoid hoarding</td>
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<tr>
<td>Information</td>
<td>Credibility and validity</td>
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Table 6.1 Ethical influence on business

6.15 Sources of Ethical Standards

Ethical standards originate and develop from the following sources.

Societal attitudes
Decline in society’s norms is reflected in greater emphasis on permissiveness, decline in the influence of family and orientation towards quantity as opposed to quality. These tend to lower ethical standards. Emphasis on public disclosure and media information increase awareness and consciousness creating or at least enforcing existing ethical standards. Society is becoming less independent as individuals become more oriented to groups. Groups establish norms which can have a significant impact on individual behaviour. However, these differ from group-to-group causing conflict and confusion concerning which standards should be followed.
Competitive pressures
Our economic system is built on two fundamental concepts of efforts and competition. The essence of these beliefs is that working hard and outperforming others in achieving goals will be rewarded with high levels of success. In recent years, however, ‘winning at all costs’ philosophy has become prominent. This philosophy tends to substitute unethical practices, for example, cheating for hard work. For example, business firms often make questionable claims in their advertisements in order to outperform their competitors.

Legal environment
The legislative environment is confusing and full of loopholes. Legal interpretations and entanglements often make it difficult for managers to know exactly what course to take or what decisions to make. Even then law affects ethical behaviour. Many a time what is considered ethical is made law.

Code of ethics
Code of conduct serves as a guide to all members of the profession or industry. A code of ethics requires and prohibits specific practices. It may not deter the misbehaviour of intentional wrong doers, but it reminds employees that the company is fully committed to meeting its standards and asks them to incorporate these standards into their daily activities. Codes of conduct have been developed in medical, legal and accounting professions. There is, however, universal code of conduct to guide managers.

Advocates of code of conduct argue that it will improve the confidence for customers and others in the quality of products and services. It will guide managers in their daily jobs. In the long-run, it will improve the quality of management talent reaching the top-level. On the other hand, critics argue that it will restrict the freedom of managers. The environment of any organisation is too dynamic for any specific code of conduct. A strict code will introduce rigidity while a loose code of conduct would result in different interpretations to suit individual needs. It would be very difficult to enforce a code of conduct.

Code of ethics is necessary and useful. If stated in operational terms and supported by organisations, it can be a guide to socially responsible behaviour. There are several ways of institutionalising managerial ethics. Social audit and code of ethics have already been described. Ethics committees, ombudsman offices, judicial boards and ethics training are other ways. Some companies are arranging training programmes to teach their employees how to confront moral problems in business. Some firms have judicial boards that rule on ethical questions. Others have appointed ombudsman (an officer to investigate decisions from the viewpoint of ethics). Taking a long-term perspective and improving organisational communication both internally and externally can also be helpful in improving managerial ethics.

6.16 Benefits of Managing Ethics at the Workplace
Many people are used to reading or hearing of the moral benefits of attention to business ethics. However, there are other types of benefits, as well. The following list describes various types of benefits from managing ethics in the workplace.

Attention to business ethics has substantially improved society
A matter of decades ago, children in our country worked 16-hour days. Workers’ limbs were torn off and disabled workers were condemned to poverty and often to starvation. Trusts controlled some markets to the extent that prices were fixed and small businesses choked out. Price fixing crippled normal market forces. Employees were terminated based on personalities. Influence was applied through intimidation and harassment. Then society reacted and demanded that businesses place high value on fairness and equal rights. Anti-trust laws were instituted. Government agencies were established. Unions were organised. Laws and regulations were established.

Ethics programmes help maintain a moral course in turbulent times
As noted earlier in this document, Wallace and Pekel explain that attention to business ethics is critical during times of fundamental change, times much like those faced now by businesses, either non-profit or for profit. During times of change, there is often no clear moral compass to guide leaders through complex conflicts about what is right or wrong. Continuing attention to ethics in the workplace sensitises leaders and staff to how they want to act consistently.
**Ethics programmes cultivate strong teamwork and productivity**
Ethics programmes align employee behaviours with those top priority ethical values preferred by leaders of the organisation. Usually, an organisation finds surprising disparity between its preferred values and the values actually reflected by behaviours in the workplace. Ongoing attention and dialogue regarding values in the workplace builds openness, integrity and community, the critical ingredients of strong teams in the workplace. Employees feel strong alignment between their values and those of the organisation. They react with strong motivation and performance.

**Ethics programmes support employee growth and meaning**
Attention to ethics in the workplace helps employees face reality, both good and bad in the organisation and themselves. Employees feel full confidence they can admit and deal with whatever comes their way. Bennett, in his article ‘Unethical Behaviour, Stress Appear Linked’ (Wall Street Journal, April 11, 1991, p. B1), explained that a consulting company tested a range of executives and managers. Their most striking finding was that the more emotionally healthy executives, as measured on a battery of tests, the more likely they were to score high on ethics tests.

**Ethics programmes are an insurance policy**
They help in ensuring that policies are legal. There are an increasing number of lawsuits in regard to personnel matters and to effects of an organisation’s services or products on stakeholders. As mentioned earlier in this document, ethical principles are often state-of-the-art legal matters. These principles are often applied to current, major ethical issues to become legislation. Attention to ethics ensures highly ethical policies and procedures in the workplace. It’s far better to incur the cost of mechanisms to ensure ethical practices now than to incur costs of litigation later. A major intent of well-designed personnel policies is to ensure ethical treatment of employees, e.g., in matters of hiring, evaluating, disciplining, firing, etc. Drake and Drake note that “an employer can be subject to suit for breach of contract for failure to comply with any promise it made, so the gap between stated corporate culture and actual practice has significant legal, as well as ethical implications.”

**Ethics programmes help in avoiding criminal acts ‘of omission’ and can lower fines**
Ethics programmes tend to detect ethical issues and violations early on so they can be reported or addressed. In some cases, when an organisation is aware of an actual or potential violation and does not report it to the appropriate authorities, this can be considered a criminal act, e.g., in business dealings with certain government agencies, such as the Defence Department. The recent Federal Sentencing Guidelines specify major penalties for various types of major ethics violations. However, the guidelines potentially lower fines, if an organisation has clearly made an effort to operate ethically.

**Ethics programmes help to manage values associated with quality management, strategic planning and diversity management**
Ethics programmes identify preferred values and ensure that organisational behaviours are aligned with those values. This effort includes recording the values, developing policies and procedures to align behaviours with preferred values, and then training all personnel about the policies and procedures.

This overall effort is very useful for several other programmes in the workplace that require behaviours to be aligned with values, including quality management, strategic planning and diversity management. Total Quality Management includes high priority on certain operating values, e.g., trust among stakeholders, performance, reliability, measurement, and feedback. Eastman and Polaroid use ethics tools in their quality programmes to ensure integrity in their relationships with stakeholders. Ethics management techniques are highly useful for managing strategic values, e.g., expand market share, reduce costs, etc. McDonnell Douglas integrates their ethics programmes into their strategic planning process. Ethics management programmes are also useful in managing diversity. Diversity is much more than the colour of people’s skin. It’s acknowledging different values and perspectives. Diversity programmes require recognising and applying diverse values and perspectives. These activities are the basis of a sound ethics management programme.
Ethics programmes promote a strong public image
Attention to ethics is also strong public relations; admittedly, managing ethics should not be done primarily for reasons of public relations. However, the fact that an organisation regularly gives attention to its ethics can portray a strong positive to the public. People see those organisations as valuing people more than profit, as striving to operate with the utmost of integrity and honor. Aligning behaviour with values is critical to effective marketing and public relations programmes. Consider how Johnson and Johnson handled the Tylenol crisis versus how Exxon handled the oil spill in Alaska. Bob Dunn, President and CEO of San Francisco-based Business for Social Responsibility, puts it best, “Ethical values, consistently applied, are the cornerstones in building a commercially successful and socially responsible business.”

Overall benefits of ethics programmes
Donaldson and Davis, in ‘Business Ethics? Yes, But What Can it Do for the Bottom Line?’ [Management Decision, V28, N6, 1990] explain that managing ethical values in the workplace legitimises managerial actions, strengthens the coherence and balance of the organisation’s culture, improves trust in relationships between individuals and groups, supports greater consistency in standards and qualities of products, and cultivates greater sensitivity to the impact of the enterprise’s values and messages. Formal attention to ethics in the workplace is the right thing to do.

6.17 Ethically Effective Management
For the effective management of Business Ethics, the following points were developed:
- Integrity is the fundamental requirement for successful Management.
- Effective communication which is the life breath of modern business commences with right attitudes, rational emotions and sincere feelings, and not simply words. Words cannot communicate, if they fail to express the substance of communication precisely, clearly and effectively.
- Employees of every business organisation have to enjoy their fundamental rights properly with a view to discharging their obligations to the society they live in. Hence, they should be properly enthused by educational programmes, persuaded, motivated and trained in a manner that they can nurture high moral values and obligations towards their organisation. Work cannot be accomplished by order, but by persuasion and by inculcating in workers a sense of belongingness and common purpose.
- Every employee has right to his or her dignity. Every individual worker in an organisation has his sense of worth and contribution to his organisation.
- Human relations and not merely products have relevance which should be recognised by every healthy business organisation.
- Self-management in industry has to be successfully encouraged. Self-management is the ‘Summum Bonum’ (supreme good) of every organisation. Without Self-management, the proper management of other persons became meaningless.
- It is necessary to encourage decision-making at the operational level, so as to make it purposeful and effective.
- Delegation of responsibility must always be accompanied by appropriate delegation of authority.
- Workers have to be tactfully guided so as to enable them to understand that their duties are accompanied by concomitant responsibilities.
- If subordinates come up with well-reasoned suggestions, their bosses should always lend an ear and understand the finer points of those suggestions.
- In management, democratic leadership provides more satisfactory experiences outwardly and as well as inwardly to each and every member of the organisation.
- Every benevolent organisation should take pain to convey the appropriate stance of the company in regard to profits. In this way, truth triumphs favourably in the interests of the organisation.
- It is the responsibility of every management to discharge its social responsibility.
- Workers should be considered as partners in business because it is they who contribute to the productivity, progress and profitability of their company.
Enlightened leadership means making people function as responsible leaders, consumers and citizens.

Every business organisation should understand that the company exists because people exist, with all their desires and wants, hence the business should function in the larger interest of the national and international communities.

The above information was tabulated and formulated into following Fig.6.6 which will be useful for the understanding of the concept.

As the ethical values and principles exhaustively discussed above are identified as core human virtues, it is expected that every member of the board and the senior management team of a corporate entity should possess and develop such virtues for the good of mankind. Unless there is complete cohesion, mutual trust and perfect understanding between the promoters (people who hold majority stake in a company), board and senior management team to carry on the business activities on ethical lines and by fair means for common good of society rather than promotion of their self interest and personal enrichment, there will be conflicts, frictions, disagreements and disputes between them relating good corporate governance, which may come out in the open sullying the good image and reputation of an organisation nurtured and built over a period of time.
In the broader sense, business ethics involves a number of complex areas of a business management and administration, such as economic systems, organisational constitution, organisational policy, business strategy-based on intuition and level of existing and anticipated competition in the market place, functional operations and individual conduct of the core team, which can throw light to the level of ethical values and practices existing in a corporate enterprise and how they can be improved by pedagogy. In substance, business ethics aims to manage all relationships both internal and external with total commitment and integrity and with a view to ensure the long-term survival of a corporate organisation. An organisation can grow, expand and be successful only, if there is adequate disclosure of information at all levels, cross fertilisation of ideas with the active involvement of a knowledgeable and talented work force, transparency in business dealings resulting in shared vision and values.

Every corporate entity must create a good environment for creativity and excellence providing enough independence and authority to its staff at all levels, but at the same time it must establish adequate, proper, effective monitoring and control systems, so as to ensure that its business activities are properly conducted within the legal and regulatory framework. It should be recognised and appreciated that any serious violation of ethical values and principles in its functioning will not only undermine the public confidence in it, bring bad publicity, but ultimately result in strong intervention by Government and a number of regulatory bodies. No doubt on account of various pressures exercised by different sections of society, a company will always be subject to supervision and regulation of its activities as a responsible social entity on its size, behaviour, governance, accounting, legal and social compliances under various laws, rules and regulations applicable to it.
Summary

- Ethics is derived from the Greek word ‘ethos’ which means a person’s fundamental orientation toward life.
- Ethics refers to the moral standards used to govern behaviour and to determine right or wrong, good or bad.
- The Oxford English Dictionary defines “ethics as the science of morals, rules of conduct or moral principles.”
- Personal Ethics is defined as “the rules by which an individual lives his or her personal life.”
- Professional Ethics indicates the moral way the professional should behave in his domain of profession, be it engineering, medical, legal or business.
- Traditionally, normative ethics (also known as moral theory) was the study of what makes actions right and wrong.
- Applied ethics is a discipline of philosophy that attempts to apply ethical theory to real-life situations.
- Values are the moral beliefs held by an individual, an organisation and a society.
- Business ethics has deep and wide roots in society.
- Work refers to the job and the tasks or responsibilities associated with it.
- Code of conduct serves as a guide to all members of the profession or industry.
- Ethics programmes tend to detect ethical issues and violations early on, so they can be reported or addressed.
- Ethics programmes identify preferred values and ensuring organisational behaviours are aligned with those values.
- Total Quality Management includes high priority on certain operating values, e.g., trust among stakeholders, performance, reliability, measurement, and feedback.

References


Recommended Reading

Self Assessment

1. Where has the term ethics derived from?
   a. Ethics is derived from the French word ‘ethos’.
   b. Ethics is derived from the English word ‘ethos’.
   c. Ethics is derived from the Greek word ‘ethos’.
   d. Ethics is derived from the Latin word ‘ethos’.

2. Ethical issues are ________ in business.
   a. inevitable
   b. avoidable
   c. not inevitable
   d. unpredicted

3. Match the following

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>1. Meta-ethics</td>
<td>A. They are the moral beliefs held by an individual, an organisation and a society.</td>
<td></td>
</tr>
<tr>
<td>2. Applied ethics</td>
<td>B. They are the claims of the individual or organisation.</td>
<td></td>
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<tr>
<td>3. Values</td>
<td>C. It deals with the nature of moral judgement.</td>
<td></td>
</tr>
<tr>
<td>4. Rights</td>
<td>D. It looks at controversial issues like war, animal rights and capital punishment and human rights.</td>
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   a. 1-B, 2-A, 3-D, 4-C
   b. 1-D, 2-C, 3-B, 4-A
   c. 1-C, 2-D, 3-A, 4-B
   d. 1-A, 2-B, 3-C, 4-D

4. Which of the following is concerned with the content of moral judgements and the criteria for what is right or wrong (H Carens – 1996)?
   a. Normative ethics
   b. Meta-ethics
   c. Applied ethics
   d. Virtue Ethics

5. Which of the following are the obligations of a person or an organisation?
   a. Rights
   b. Values
   c. Moral
   d. Duties

6. Which of the following statement is false?
   a. Modern society is an industrial society.
   b. Ethical considerations are as important in management as in any other occupation.
   c. Value refers to the job and the tasks or responsibilities associated with it.
   d. The objectives of an organisation influence the values of its members.
7. Which of the following is also known as moral theory?
   a. Applied ethics
   b. Meta-ethics
   c. Personal ethics
   d. Normative ethics

8. Which of the following statement is true?
   a. Business ethics has deep and wide roots in business.
   b. Business ethics has deep and wide roots in society.
   c. Business ethics has deep and wide roots in corporate.
   d. Business ethics has deep and wide roots in environment.

9. The ________ environment is confusing and full of loop holes.
   a. business
   b. legislative
   c. corporate
   d. ethical

10. Aligning behaviour with values is critical to effective ________ and public relations programmes.
    a. selling
    b. marketing
    c. public
    d. business
Chapter VII
Professional Ethics, Codes of Conduct and Moral Responsibility

Aim
The aim of this chapter is to:

• introduce professional ethics, codes of conduct and moral responsibility
• explain professional ethics
• explicate professional codes of ethics and codes of conduct

Objectives
The objectives of this chapter are to:

• explain code of conduct
• elucidate moral responsibility
• explicate some historical background

Learning outcome
At the end of this chapter, you will be able to:

• identify free will to moral responsibility
• understand the recent work on the ‘concept of responsibility’
• recognise developments after Strawson
7.1 Introduction
Applied ethics, as opposed to theoretical ethics, examines practical ethical issues those contended by the societies across the globe. It does so by analysing those issues from the vantage point of one or more ethical theories. Whereas ethical theory is concerned with establishing logically coherent and consistent criteria, applied ethics is concerned with establishing logically coherent and consistent criteria in the form of standards and rules for evaluating moral problems. The principal aim of applied ethics is to analyse specific moral problems through the application of ethical theory to the scenarios where conflicting ideas support both sides of the issue. Contemporary American scholar in ethics Prof. Herman T. Tavani writes, “As such, those working in fields of applied ethics are not inclined to debate some of the finer points of individual ethical theories. Instead, their interest in ethical theory is primarily with how one or more theories can be successfully applied to the analysis of specific moral problems that they happen to be investigating.”

For an example of a practical ethics issue, would be extravagant use of cyber technology and the dispute is the question of whether the exchange of proprietary software, or a digital formatted music files known as MP3 files, over the internet should be permitted. Those advocating the free exchange of MP3 files could appeal to one or more ethical theory that is based on the principle that our policies and laws should be such that they produce the greatest good (happiness) for the greatest number of people. A utilitarian might argue that MP3 files should be distributed freely over the internet because the consequences of allowing such a practice would make the majority of users happy and would thus contribute to the greatest good for the greatest number of persons affected.

On the practical grounds, others might argue that allowing this proprietary material to be exchanged freely over the internet would violate the rights of those who created, and who legally own the material. Proponents of this view could appeal to a non-utilitarian principle or theory that is grounded in the notion of respecting the rights of individuals. According to this view, the concern is with protecting the rights of individuals who legally own the proprietary material in question, irrespective of the happiness that might or might not result for the majority of internet users.

Understanding cyber ethics as a field of applied ethics that examines moral issues pertaining to cyber technology is an important first step. However, much more needs to be said about the perspectives that interdisciplinary researchers bring to their analysis of the issues that make up this relatively new field. Most scholars and professionals conducting research in this field of applied ethics have proceeded from one of the three different perspectives; professional ethics, philosophical ethics or descriptive ethics. Gaining a clearer understanding of what is meant by each of these perspectives is useful at this point.

7.2 Professional Ethics
Professional ethics could suggest that professionals have their own system of ethics, separate from ordinary ethics. Of course, one could reasonably argue that independent of whether a particular moral issue happens to arise in either a professional or a non-professional context, ethics is ethics. The same ethical rules involving honesty, fairness, and so forth should apply to professionals as well as to ordinary individuals, so that if it is wrong for ordinary people to steal and lie, then it is wrong for professionals as well. Thus, one might conclude that a separate field of study called ‘professional ethics’ is not really needed. However, many ethicists argue that the kinds of moral issues affecting professionals are sufficiently distinct and specialised to warrant separate moral obligations, which exceed those of ordinary individuals. To grasp the essential points in the arguments advanced by these ethicists, it is useful first to understand what is meant by ‘profession’ and ‘professional’. According to the American professor in Engineering Prof. Allan Firmage, “A profession can be understood in terms of the attributes and requirements of a professional practice.”

Firmage points out that the American Society of Civil Engineers (ASCE) defines a profession as a “calling in which special knowledge and skill are used in the given field for the service of mankind.” So ‘having a calling, ‘possessing special knowledge and skill’, and ‘providing a service’ are examples of attributes that would distinguish a profession from many ordinary occupations.
Prof. Ernest Greenwood (1920 – 2004) a renowned American social philosopher believes that professions are occupational fields that can be distinguished in terms of the following five characteristics:

- Systematic theory
- Authority
- Community sanction
- Ethical codes
- Culture

For the most part, these five characteristics would certainly apply to the computing profession as well. Consider that the field of computing (relatively known as Information Technology or simply IT) has a systematic theory of knowledge (computer science); a number of professional societies with ethical codes and an emerging culture (sometimes referred to as a high-tech culture) and poses significant challenges within the realm of Applied Ethics. According to Ernest Greenwood, “The computing profession differs from traditional professions, such as medicine and law however, with respect to individual autonomy for its members. While many doctors and lawyers work in private practice, most computer professionals are not self-employed; even though some work as independent consultants, most are employed by corporations.” Irrespective of whether a professional is self-employed or by a government agency or a private entity, these challenges trigger further evaluation within the context of Applied Ethics.

7.2.1 Professionals

Professionals who comprise a given profession also tend to possess certain defining attributes and requirements. According to the ‘Engineers’ Council for Professional Development (ECPED), “a professional is one who recognises his or her obligation to the society by living up to established and accepted codes of conduct.” Medical doctors, lawyers, accountants, technologists and other professionals often find themselves in situations in which their decisions and actions can have significant social effects. For example, medical doctors can prescribe the use of certain drugs for their patients, who otherwise would have no legal access to them, and lawyers are bound by special obligations, such as client confidentiality that would not apply if they were acting as ordinary citizens. In these cases, a professional’s roles and responsibilities are said to differentiate professionals from non-professional persons.

Prof. Elizabeth Buchanan, a renowned contemporary American scholar in Applied Ethics, believes that the roles and responsibilities of professionals are differentiated from ordinary individuals because ‘professionals are experts in a field, which provides them an advantage over the lay person and that professional’s work has the potential to impact, either positively or negatively, the general public at large’.

Buchanan goes on to note that computer professionals (or what she calls ‘information professionals’) have the potential to adversely affect an ‘increasingly large and diverse clientele by failing to act responsibly, fairly, timely and appropriately’. Arguably, these roles and responsibilities differentiate at least certain kinds of computer professionals from ordinary individuals. The extent, to which a computer professional’s roles and responsibilities are highly differentiated, however, is a matter of some dispute. To understand why this is so, it would first help to understand what exactly is meant by the expression ‘computer professional’.

Professional ethics in an organisation would mean a set of values, principles and morals followed in the best defined manner governed by broader code of ethics for the given entity. It is these codes of ethics that provides broad guidelines as to what is right and what is wrong, which decision to take and which one to leave. How much can you flex and how much to restrict. Taking professional and ethical decisions aren’t always easy. Prof. Mark Miller an American scholar writes, “Professional code of ethics can be defined as, set of principles that all employees must comply and ensure ethical decision-making even in difficult situations. Professional code of ethics is said to be the base platform for every employee to build his career on. Employees define different criteria and exceptions based on the heterogeneous situations.”
7.3 Professional Codes of Ethics and Codes of Conduct

Under the definition of professional code of conduct, an unethical behaviour by few employees could cost a lot to the company. It will not only sabotage the employee’s career this could bring bad name to the organisation as a whole. If the employees of the organisation do not behave professionally by following code of ethics, it will reflect badly on the organisation’s image and this could very damaging overall. It is always advised that the organisation must set very high standards for professional code of ethics in order to maintain a stance of trust as well as integrity for which everyone is liable to and everyone can benefit from. This code of professional ethics once imbibed in the culture, always reflects various aspects of their lives: Professional code of ethics must be broadly divided in to two broad sections.

7.3.1 Compulsory Standard

The mandatory standards must apply to all grades of employees working for an organisation. It would define that these mandatory standards must be adhered to for professional, legal and ethical reasons. Penalty to the violation of any of these standards must also be an integral part of the compulsory standard.

7.3.2 Ideal Standard

The ideal standard would be defined as the best benchmarking standard available in the market and employees must constantly strive to reach up to that level. It will give the employees a broad outline of what the standardisation norm is and not just a division of what is expected and not expected.

A quick example to support this can be the decision-making choices, such as to work in favour of the society one lives in, or complying to the data protection act, accountability and responsibility for both success and failure, promising what you can deliver, etc., So all these above stated choices and related qualities are subjective and too ideal and hence will not give a very clear cut cross sectional analysis and information.

There are multiple ways of imbibing the professional code of ethics in employees. They are as follows:

• Regular ethics training on professionalism.
• During induction of a new joinee, companies to imbibe a compulsory security and professionalism training.
• Awarding mechanism for employees who show professional attitudes and behaviours.
• Penalty violations which could also include firing of a resource for unethical behaviour.
• Encouragement to set examples for the junior staff on professionalism, integrity and ethics.
• Framework to encourage reporting of ethical violations to upper management on anonymous basis, such as ‘Whistle Blower Protection’.
• Professional code of ethics must be a fair blend of respect for coworkers, juniors and seniors, responsibility for one’s role and honesty in the conduct.

7.4 Code of Conduct

In the current contest of globalisation, companies are bound to operate in various geographies and cater to different societal and ethical demands. However the recent outbreak of scandals in the corporate world questioned the ethical foundations for such companies. The extent of investment made in the ‘Code of Conduct’ for the companies and commitment to train its employees in spreading the culture of ethical conduct among its employees across the globe has increased. Given this background, most of the organisations now seem to have a comprehensive code of conduct in place and applicable to all employees. Companies are also creating special focus training modules during the induction process for new employees during the induction process. While the companies are free to design their own code of conduct, however they are general guidelines for developing code of conduct, such as that it should be clear and written in plain English. It should outline what sorts of behaviour are expected of employees, as well as their responsibilities towards their organisation and its customers, clients or service users. A code of conduct does not imply a generic document, as it will be very different for specific professions.
Every code of conduct should go into realm of business ethics of an organisation. These are usually targeted to explain the non-economic values of an organisation. Business ethics explains the philosophy of an organisation and includes the rights and duties of employees and the corporation as a whole, as well as the relationship between the corporation and its stakeholders.

Codes of conduct vary from one profession to another, but always set out the behaviours and ethics that are expected of its employees or members. A good code of conduct is also regularly reviewed and updated, in consultation with the ethicists and employees it covers. Contemporary philosopher on the ‘Critical Thinking’, Richard Paul writes, “Codes of conduct will focus mainly on expected behaviours that are not related to the profit-making of an organisation, rather on behaviours that are expected amongst each other, other professionals, the customers/clients/service users and the wider community. A code of conduct will also make it clear to customers/clients/service users what they can expect from the people that they are dealing with and what is and isn’t considered acceptable behaviour in their dealings with them.”

7.5 Moral Responsibility

There is an academic debate on the need to separate ‘moral’ and ‘responsibility’, just as to separate the concept ‘free’ from the concept of ‘will’ in order to better understand ‘free will’. Then we may realise the need to go even further and clarify the relationship between free will and moral responsibility. Some philosophers deflect direct discussion of free will and study it only as the ‘control condition for moral responsibility’.

When a person performs or fails to perform a morally significant action, we sometimes think that a particular kind of response is warranted. Praise and blame are perhaps the most obvious forms such reactions could eventually resort to. For example, one who encounters a car accident may be regarded as worthy of praise for having saved a child from inside the burning car, or alternatively, one may be regarded as worthy of blame for not having used one’s mobile phone to call for help. To regard such agents (Samaritan principles) as worthy of one of these reactions is to ascribe moral responsibility to them on the basis of what they have done or left undone. Thus, to be morally responsible for something, say an action, is to be worthy of a particular kind of reaction, praise, blame, or something akin to these for having performed it.

A comprehensive theory of moral responsibility would elucidate the following:

- The concept, or idea, of moral responsibility itself.
- The criteria for being a moral agent, i.e., one who qualifies generally as an agent open to responsibility ascriptions (e.g., only beings possessing the general capacity to evaluate reasons for acting can be moral agents).
- The conditions under which the concept of moral responsibility is properly applied, i.e., those conditions under which a moral agent is responsible for a particular something (e.g., a moral agent can be responsible for an action she has performed only if she performed it freely, where acting freely entails the ability to have done otherwise at the time of action).
- Possible objects of responsibility ascriptions (e.g., actions, omissions, consequences, character traits, etc.).

7.6 Some Historical Background

The outline of the origins and trajectory of reflection on moral responsibility in the Western philosophical tradition shows that a distinction will be drawn between two concepts of moral responsibility that have exerted considerable influence on subsequent thinkers.

An understanding of the concept of moral responsibility and its application is presented implicitly in some of the earliest surviving Greek texts, i.e., the Homeric epics (circa 8th century BC, but no doubt informed by a much earlier oral tradition). In these texts, both human and superhuman agents are often regarded as fair targets of praise and blame on the basis of how they have behaved, and at other times, an agent’s behaviour is excused because of the presence of some factor that has undermined his/her control. Reflection on these factors gave rise to fatalism, the view that one’s future or some aspect of it is predetermined, e.g., by the Gods, or the stars, or simply some facts about truth and time, such a way as to make one’s particular deliberations, choices and actions irrelevant to whether that particular future is realised (recall, e.g., the plight of Oedipus).
If some particular outcome is fated, then it seems that the agent concerned could not be morally responsible for that outcome. Likewise, if fatalism were true with respect to all human futures, then it would seem that no human agent could be morally responsible for anything. Though this brand of fatalism has sometimes exerted significant historical influence, most philosophers have rejected it on the grounds that there is no good reason to think that our futures are fated in the sense that they will unfold no matter what particular deliberations we engage in, choices we make, or actions we perform.

Aristotle (384–323 BC) seems to have been the first to construct explicitly a theory of moral responsibility. In the course of discussing human virtues and their corresponding vices, Aristotle begins with a brief statement of the concept of moral responsibility that it is sometimes appropriate to respond to an agent with praise or blame on the basis of her actions and/or dispositional traits of character. A bit later, he clarifies that only a certain kind of agent qualifies as a moral agent and is thus properly subject to ascriptions of responsibility, namely, one who possesses a capacity for decision. For Aristotle, a decision is a particular kind of desire resulting from deliberation, one that expresses the agent’s conception of what is good.

The remainder of Aristotle’s discussion is devoted to spelling out the conditions under which it is appropriate to hold a moral agent blameworthy or praiseworthy for some particular action or trait. His general proposal is that one is an apt candidate for praise or blame if and only if the action and/or disposition is voluntary. According to Aristotle, a voluntary action or trait has two distinctive features. First, there is a control condition, the action or trait must have its origin in the agent. That is, it must be up to the agent whether to perform that action or possess the trait. It cannot be compelled externally. Secondly, Aristotle proposes an epistemic condition, the agent must be aware of what it is she is doing or bringing about.

There is an instructive ambiguity in Aristotle’s account of responsibility, an ambiguity that has led to competing interpretations of his view. Aristotle aims to identify the conditions under which it is appropriate to praise or blame an agent, but it is not entirely clear how to understand the pivotal notion of appropriateness in his conception of responsibility.

There are at least two possibilities as follows:

- Praise or blame is appropriate in the sense that the agent deserves such a response, given his behaviour and/or traits of character.
- Praise or blame is appropriate in the sense that such a reaction is likely to bring about a desired consequence, namely an improvement in the agent’s behaviour and/or character.

These two following possibilities may be characterised in terms of two competing interpretations of the concept of moral responsibility:

- The merit-based view, according to which praise or blame would be an appropriate reaction toward the candidate if and only if she merits in the sense of ‘deserves’ such a reaction.
- The consequentialist view, according to which praise or blame would be appropriate if and only if a reaction of this sort would likely lead to a desired change in the agent and/or her behavior.

Scholars disagree about which of the above views Aristotle endorsed, but the importance of distinguishing between them grew as philosophers began to focus on a newly conceived threat to moral responsibility. While Aristotle argued against a version of fatalism, he may not have recognised the difference between it and the related possible threat of causal determinism. Causal determinism is the view that everything that happens or exists is caused by sufficient antecedent conditions, making it impossible for anything to happen or be other than it does or is. One variety of causal determinism, scientific determinism, identifies the relevant antecedent conditions as a combination of prior states of the universe and the laws of nature.
Another, theological determinism identifies those conditions as being the nature and will of God. It seems likely that theological determinism evolved out of the shift, both in Greek religion and in Ancient Mesopotamian religions, from polytheism to belief in one sovereign God, or at least one God who reigned over all others. The doctrine of scientific determinism can be traced back as far as the Pre-Socratic Atomists (5 BC), but the difference between it and the earlier fatalistic view seems not to be clearly recognised until the development of Stoic philosophy (3 BC). Though fatalism, like causal determinism, might seem to threaten moral responsibility by threatening an agent’s control, the two differ on the significance of human deliberation, choice, and action. If fatalism is true, then human deliberation, choice, and action are completely otiose, for what is fated will transpire no matter what one chooses to do. According to causal determinism, however, one’s deliberations, choices, and actions will often be necessary links in the causal chain that brings something about. In other words, even though our deliberations, choices, and actions are themselves determined like everything else, it is still the case, according to causal determinism, that the occurrence or existence of yet other things depends upon our deliberating, choosing and acting in a certain way.

From the time of the Stoics (Hellenistic philosophy founded in Athens by Zeno of Citium in the early 3 BC), the thesis of causal determinism and its ramifications, if true, have taken centre stage in theorising about moral responsibility. During the Medieval period, especially in the work of Augustine (354–430) and Aquinas (1225-1274), reflection on freedom and responsibility was often generated by questions concerning versions of theological determinism, including most prominently the following questions:

• Does God’s sovereignty entail that God is responsible for evil?
• Does God’s foreknowledge entail that we are not free and morally responsible since it would seem that we cannot do anything other than what God foreknows we will do?

During the modern period, there was renewed interest in scientific determinism; a change attributable to the development of increasingly sophisticated mechanistic models of the universe culminating in the success of Newtonian physics. The possibility of giving a comprehensive explanation of every aspect of the universe, including human action in terms of physical causes now seemed much more plausible. Many thought that persons could not be free and morally responsible, if such an explanation of human action were possible. Others argued that freedom and responsibility would not be threatened should scientific determinism be true. In keeping with this focus on the ramifications of causal determinism for moral responsibility, thinkers may be classified as being one of the following two types:

• An incompatibilist, about causal determinism and moral responsibility, is one who maintains that if causal determinism is true, then there is nothing for which one can be morally responsible.
• A compatibilist is one who holds that a person can be morally responsible for some things, even if both who she is and what she does is causally determined.

In Ancient Greece, these positions were exemplified in the thought of Epicurus (341–270 BCE) and the Stoics (3 BC), respectively. Above, an ambiguity in Aristotle’s conception of moral responsibility was highlighted that it was not clear whether he endorsed a merit-based vs. a consequentialist conception of moral responsibility. The history of reflection on moral responsibility demonstrates that how one interprets the concept of moral responsibility strongly influences one’s overall account of moral responsibility. For example, those who accept the merit-based conception of moral responsibility have tended to be incompatibilists. That is, most have thought that if an agent were to genuinely merit praise or blame for something, then he would need to exercise a special form of control over that thing (e.g., the ability at the time of action to both perform or not perform the action) that is incompatible with one’s being causally determined.

In addition to Epicurus, we can cite early Augustine, Thomas Reid (1710–1796), and Immanuel Kant (1724–1804) as historical examples here. Those accepting the consequentialist conception of moral responsibility, on the other hand, have traditionally contended that determinism poses no threat to moral responsibility since praising and blaming could still be an effective means of influencing another’s behaviour, even in a deterministic world. Thomas Hobbes (1588–1679), David Hume (1711–1776), and John Stuart Mill (1806–1873) are, along with the Stoics, representatives of this view. This general trend of linking the consequentialist conception of moral responsibility with compatibilism about causal determinism and moral responsibility and the merit-based conception with incompatibilism continued to persist through the first half of the twentieth century.
7.7 Recent Work on the ‘Concept of Responsibility’

The issue of how best to understand the concept of moral responsibility is important, for it can strongly influence one’s view of what, if any, philosophical problems might be associated with the notion, and further, if there are problems, what might count as a solution. As discussed above, philosophical reflection on moral responsibility has historically relied upon one of following two broad interpretations of the concept:

- The merit-based view, according to which praise or blame would be an appropriate reaction toward the candidate if and only if she merits in the sense of ‘deserves’ such a reaction.
- The consequentialist view, according to which praise or blame would be appropriate if and only if a reaction of this sort would lead to a desired change in the agent and/or her behavior. Though versions of the consequentialist view have continued to garner support work in the last 50 years on the concept of moral responsibility has increasingly focused on:
  - Offering alternative versions of the merit-based view.
  - Questioning the assumption that there is a single unified concept of moral responsibility.

Increased attention focusing on the stance of regarding and holding persons morally responsible has generated much of the recent work on the concept of moral responsibility. All theorists have recognised features of this practice specifically, inner attitudes and emotions, their outward expression in censure or praise, and the imposition of corresponding sanctions or rewards.

In other words, it was typically assumed that blame and praise depended upon a judgement or belief (pre-reflective in most cases), that the agent in question had satisfied the objective conditions on being responsible. These judgements were presumed to be independent of the inner attitudinal/emotive states involved in holding responsible in the sense that reaching such judgements and evaluating them required no essential reference to the attitudes and emotions of the one making the judgement. For the holder of the consequentialist view, this is a judgement that the agent exercised a form of control that could be influenced through outward expressions of praise and blame in order to curb or promote certain behaviours. For those holding the merit view, it is a judgement that the agent has exercised the requisite form of metaphysical control, e.g., that she could have done otherwise at the time of action.

If holding responsible is best understood as resting on an independent judgement about being responsible, then it is legitimate to inquire whether such underlying judgements and their associated outward expressions can be justified, as a whole, in the face of our best current understanding of the world, e.g., in the face of evidence that our world is possibly deterministic. According to incompatibilists, a judgement that someone is morally responsible could never be true if the world was deterministic; thus praising and blaming in the merit-based sense would be beside the point. Compatibilists, on the other hand, contend that the truth of determinism would not undermine the relevant underlying judgements concerning the efficacy of praising and blaming practices, thereby leaving the rationale of such practices intact.

7.8 Free Will to Moral Responsibility

In his landmark essay, ‘Freedom and Resentment,’ contemporary philosopher P. F. Strawson (1962) sets out to adjudicate the dispute between those compatibilists who hold a consequentialist view of responsibility and those incompatibilists who hold the merit-based view. Both are wrong, Strawson believes, because they distort the concept of moral responsibility by sharing the prevailing assumption sketched above, the assumption that holding persons responsible rests upon a theoretical judgement of their being responsible. According to Strawson, the attitudes expressed in holding persons morally responsible are varieties of a wide range of attitudes deriving from our participation in personal relationships, e.g., resentment, indignation, hurt feelings, anger, gratitude, reciprocal love, and forgiveness. The function of these attitudes is to express “…how much we actually mind, how much it matters to us, whether the actions of other people and particularly some other people reflect attitudes towards us of good will, affection, or esteem on the one hand or contempt, indifference, or malevolence on the other.”
These attitudes are thus participant reactive attitudes, because they are as follows:

- Natural attitudinal reactions to the perception of another’s good will, ill will, or indifference expressed from the stance of one who is immersed in interpersonal relationships.
- Who regards the candidate held responsible as a participant in such relationships as well.

Strawson argued in 1962 that whatever the deep metaphysical truth on the issues of determinism and free will, people would not give up talking about and feeling moral responsibility, praise and blame, guilt and pride, crime and punishment, gratitude, resentment, and forgiveness. These ‘reactive attitudes’ were for Strawson more real than whether they could be explained by fruitless disputes about free will, compatibilism, and determinism. They were ‘facts’ of our natural human commitment to ordinary inter-personal attitudes. He said it was ‘a pity that talk of the moral sentiments has fallen out of favour’, since such talk was ‘the only possibility of reconciling these disputants to each other and the facts’.

Strawson himself was optimistic that compatibilism could reconcile determinism with moral obligation and responsibility. He accepted the facts of determinism. He felt that determinism was true. However, he was concerned to salvage the reality of our attitudes even for libertarians, whom he described as pessimists about determinism. What is called the participant reactive attitudes are essentially natural human reactions to the good or ill will or indifference of others towards us, as displayed in their attitudes and actions. The question we have to ask is, “what effect would, or should, the acceptance of the truth of a general thesis of determinism have upon these reactive attitudes? More specifically, would, or should, the acceptance of the truth of the thesis lead to the decay or the repudiation of all such attitudes? Would or should, it mean the end of gratitude, resentment, and forgiveness of all reciprocated adult loves; of all the essentially personal antagonisms?”

As Peter Strawson changed the subject in 1962 from free will to moral responsibility, there has been an increasing tendency to equate free will with moral responsibility. From the earliest beginnings, the problem of ‘free will’ has been intimately connected with the question of moral responsibility. Most of the ancient thinkers on the problem were trying to show that we humans have control over our decisions that our actions ‘depend on us’, and that they are not predetermined by fate, by arbitrary Gods, by logical necessity, or by a natural causal determinism.

However to say that today ‘free will is understood as the control condition for moral responsibility’ is to make a serious blunder in conceptual analysis and clear thinking. Free will is clearly a prerequisite for responsibility. Whether the responsibility is a moral responsibility depends on our ideas of morality.

Here are some recent examples of conflicts in free will and moral responsibility, which we regard as an ethical fallacy. Contemporary American philosopher, John Martin Fischer says,

“Some philosophers do not distinguish between freedom and moral responsibility. Put a bit more carefully, they tend to begin with the notion of moral responsibility, and ‘work back’ to a notion of freedom; this notion of freedom is not given independent content (separate from the analysis of moral responsibility). For such philosophers, ‘freedom’ refers to whatever conditions are involved in choosing or acting in such a way as to be morally responsible.”

It is not clear that there is any single thing that people have had in mind by the term ‘free will’. Perhaps the dominant characterisation in the history of philosophy is that it is something like the freedom condition on moral responsibility. Another contemporary American philosopher Prof. Manuel Vargas says, “Roughly, the idea is that to be morally responsible for something, you had to have some amount of freedom, at some suitable time prior to the action or outcome for which you are responsible. That sense of freedom whatever it amounts to is what we mean to get at by the phrase ‘free will’.

However, there may be things for which free will might be important or other senses of free will that are independent of concerns about moral responsibility. For example, philosophers have worried whether free will is required for some human achievements to have a special worth or value, or for there to be values and valuing in any robust sense. For some Naturalists, the equation of free will and moral responsibility is driven by their goal of eliminating punishment and what they see as a ‘culture of vengeance’. The fallacious reasoning goes something like this, “If free will is required for moral responsibility, we can deny moral responsibility by denying free will.”
Naturalists seem to naively accept the ancient religious arguments that free will is an exclusive property of humans (some religions limit it to males). One strand in the naturalist argument then is to say that humans are animals and so lack free will. It will be interesting to see how they react to the establishment of a biophysical basis for behavioural freedom in lower animals. This behavioural freedom is conserved and showed up in higher animals and humans specifically as freedom of their wills.

Consider the question of how we go from being unfree agents to free agents. This is a puzzle faced by all accounts of responsibility, but there is something pressing about it in the case of libertarianism. As children we either had the indeterministic structures favoured by your favorite version of libertarianism or we lacked them altogether. If we lacked them as children, we might wonder how we came to get those structures. We might also wonder what the evidence is for thinking that we do develop those said structures. Suppose the libertarian offers us an answer to these questions, and the other empirical challenges I raised in the prior section. We would still face another puzzle. What, exactly, does the indeterminism add? What follows the discussion is not so much a metaphysical concern as it is a normative concern. It is a concern about what work the indeterminism does in libertarianism, apart from providing a way to preserve our default self-image as deliberators with genuine, metaphysically robust alternative possibilities.

Equating free will with moral responsibility, then to use spurious arguments to deny free will, and thus to deny moral responsibility, in order to oppose punishment is fine humanism but poor philosophy, and terrible science. Children have free will from birth. It is part of their biological makeup. The solution to the Vargas puzzle is that it is moral responsibility that children ‘come to get’ at some age.

Strawson’s concept of moral responsibility yields a compatibilist account of being responsible but one that departs significantly from earlier such accounts in two respects. First, Strawson’s is a compatibilist view by default only. That is, on Strawson’s view, the problem of determinism and freedom/responsibility is not so much resolved by showing that the objective conditions on being responsible are consistent with one’s being determined but rather dissolved by showing that the practice of holding people responsible relies on no such conditions and therefore needs no external justification in the face of determinism. Second, Strawson’s is a merit-based form of compatibilism. That is, unlike most former consequentialist forms of compatibilism, it helps to explain why we feel that some agents deserve our censure or merit our praise. They do so because they have violated, met, or exceeded our demand for a reasonable degree of good will.

7.9 Developments after Strawson

Most agree that Strawson’s discussion of the reactive attitudes is a valuable contribution to our understanding of the practice of holding responsible, but many have taken issue with his contentions about the insular nature of that practice, namely that:

- As propriety judgements about the reactive attitudes are strictly internal to the practice (i.e., being responsible is defined in relation to the practice of holding responsible), their justification cannot be considered from a standpoint outside that practice.
- As the reactive attitudes are natural responses deriving from our psychological constitution, they cannot be dislodged by theoretical considerations. Responding to the first of these, some have argued that it does seem possible to critique existing practices of holding responsible from standpoints outside them. For example, one might judge that either one’s own existing community practice or some other community’s practice of holding responsible ought to be modified. If such evaluations are legitimate, then, contrary to what Strawson suggested, it seems that an existing practice can be questioned from a standpoint external to it. In other words, being responsible cannot be explicated strictly in terms of an existing practice of holding responsible. This then, would suggest a possible role to be played by independent theoretical conditions on being responsible, conditions which could prove to be compatibilist or incompatibilist in nature.

Objecting to the second of Strawson’s anti-theory contentions, some have argued that incompatibilist intuitions are embedded in the reactive attitudes themselves, so that these attitudes cannot persist unless some justification can be given of them, or more weakly, that they cannot but be disturbed if something like determinism is true. Here, cases
are often cited where negative reactive attitudes seem to be dispelled or mitigated upon learning that an agent’s past includes severe deprivation and/or abuse. There is a strong pull to think that our reactive attitudes are altered in such cases because we perceive such a background to be deterministic.

If this is the proper interpretation of the phenomenon, then it is evidence that theoretical considerations, like the truth of determinism, could in fact dislodge the reactive attitudes. Versions of Strawson’s view continue to be very ably defended, and shortly, more will be said about the significant way in which his work continues to shape contemporary discussion of the concept of responsibility. However, many have taken objections of the above sort to be decisive in undermining the most radical of Strawson’s anti-theory claims.

Incompatibilists, in particular, seem largely unpersuaded and so have continued to assume a more or less traditional merit-based conception of moral responsibility as the basis for their theorising. A number of compatibilists also remain unconvinced that Strawson has successfully shown independent theoretical considerations to be irrelevant to ascriptions of responsibility. It is noteworthy that some of these have accorded the reactive attitudes a central role in their discussions of the concept of responsibility. The result has been new merit-based versions of compatibilism.

It is likely that Strawson’s and others’ writing on moral responsibility have traditionally seen themselves as attempting to articulate an account of responsible agency that would map onto what was presumed to be a unitary and shared concept of moral responsibility. However, more recently a number of authors have suggested that at least some disagreements about the most plausible overall theory of responsibility might be based on a failure to distinguish between different aspects of the concept of responsibility, or perhaps several distinguishable, but related concepts of responsibility. Broadly speaking, a distinction has been drawn between responsibility understood as attributability and responsibility as accountability. The central idea in judging whether an agent is responsible in the sense of attributability, say for an action is whether the action discloses something about the nature of the agent’s self.

Some hold additionally that a judgement of responsibility in this sense includes an assessment of the agent’s self as measured against some standard (though not necessarily a moral standard), i.e., that our interest is in what the action discloses about the agent’s evaluative commitments. Perhaps the clearest example of a conception of responsibility emphasising attributability is the so-called ‘ledger view’ of moral responsibility. According to such views, the practice of ascribing responsibility involves assigning a credit or debit to a metaphorical ledger associated with each agent. To regard an agent as praiseworthy or blameworthy in the attributability sense of responsibility is simply to believe that the credit or fault identified properly belongs to the agent.

To be responsible for an action in the sense of being accountable (or ‘appraisable’ according to the terminology of some) presupposes responsibility in the sense of attributability. However, to judge that an agent is responsible in the further sense of being accountable entails that the behaviour properly attributed to the agent is governed by an interpersonal normative standard of conduct that creates expectations between members of a shared community (whereas, the standard invoked above may or may not be thought to generate interpersonal expectations). In this way, the concept of moral responsibility as accountability is an inherently social notion, and to hold someone responsible is to address a fellow member of the moral community. By emphasising the way the reactive attitudes were tied to expectations of goodwill grounded in our interpersonal relationships, Strawson drew attention to this social aspect of responsibility. Recent attempts to further articulate how best to understand the relevant notion of holding responsible and its relation to being accountable reflect his on-going influence.

An agent is praiseworthy or blameworthy, in the sense of accountable, if one is warranted, or justified, in holding her responsible. On one popular view, holding someone responsible is interpreted as regarding him or her as an apt candidate for the reactive attitudes and possibly other forms of reward or censure based on what the agent has done. On another view, holding someone responsible is fundamentally a matter of making a moral judgement accompanied by an expectation that the agent who performed the act acknowledge the force of the judgement or provide an exonerating explanation of why he/she performed the action. To hold someone responsible is thus to be one to whom an explanation is owed. On this view, the reactive attitudes and associated practices are grounded in this more fundamental expectation.
As the reactive attitudes and associated practices may have consequences for the well-being of an agent (especially in the case of those blaming attitudes and practices involved in holding someone accountable for wrong-doing), they are justified only if it is fair that the agent be subject to those consequences. The fairness of being subject to those consequences has often, in turn, be interpreted as the source of the idea that praise and blame are justified only if they are merited in the sense of deserved.

The recognition and articulation of diversity within the concept (or amongst concepts) of moral responsibility has generated new reflection on the nature of and prospects for theories attempting to spell out the conditions on being morally responsible. While some continue to believe that a plausible unified theory can be offered that captures the conceptual diversity sketched above, a number of others have concluded that at least some of the conditions for the applicability of our folk concept are in tension with one another. For example, some have argued that while a compatibilist sense of freedom is necessary for attributability, genuine accountability would require that agents be capable of exercising libertarian freedom. A rapidly expanding body of empirical data on folk intuitions about freedom and responsibility has added fuel to this debate.

If there are irreconcilable tensions within the concept of responsibility, then the conditions of its application cannot be jointly satisfied. Of course, there have always been those, e.g., hard determinists, who have concluded that the conditions on being morally responsible cannot be met and thus that no one is ever morally responsible. However, a noteworthy new trend amongst both contemporary hard determinists and others who conclude that the conditions for the applicability of our folk concept cannot be jointly satisfied has been the move to offer a revisionist conception of moral responsibility and its associated practices rather than to reject talk about being responsible outright. Revisionism about moral responsibility is a matter of degree. Some revisionists seek to salvage much, if not most of what they take to be linked to the folk concept, while others offer more radical reconstructions of the concept and associated practices.

The future direction of reflection on moral responsibility is uncertain. On the one hand, there has been a resurgence of interest in metaphysical treatments of freedom and moral responsibility in recent years, a sign that many philosophers in this area have not been persuaded by Strawson’s central critique of such treatments. On the other hand, discussion of the place and role of the reactive attitudes in human life continues to be a central theme in accounts of the concept of responsibility.

What is clear is that the long-standing interest in understanding the concept of moral responsibility and its application shows no sign of abating. This critical analysis of moral responsibility in the above historic and didactic perspectives holds the framework for analysing the contemporary global issues within the realm of applied ethics and more so, on the subjects related to code of ethics and specifically with emphasis on the professional ethics.
Summary

- Applied ethics, as opposed to theoretical ethics, examines practical ethical issues those contended by the societies across the globe.

- The principal aim of applied ethics is to analyse specific moral problems through the application of ethical theory to the scenarios where conflicting ideas support both sides of the issue.

- Understanding cyber ethics as a field of applied ethics that examines moral issues pertaining to cyber technology is an important first step.

- Professional ethics could suggest that professionals have their own system of ethics, separate from ordinary ethics.

- A profession can be understood in terms of the attributes and requirements of a professional practice.

- Professional ethics in an organisation would mean a set of values, principles and morals followed in the best defined manner governed by broader code of ethics for the given entity.

- Under the definition of professional code of conduct, an unethical behaviour by few employees could cost a lot to the company.

- An understanding of the concept of moral responsibility and its application is presented implicitly in some of the earliest surviving Greek texts, i.e., the Homeric epics (circa 8th century BC but no doubt informed by a much earlier oral tradition).

- Aristotle (384-323 BC) seems to have been the first to construct explicitly a theory of moral responsibility.

- In Ancient Greece, these positions were exemplified in the thought of Epicurus (341–270 BCE) and the Stoics (3BC), respectively.

- Naturalists seem to naively accept the ancient religious arguments that free will is an exclusive property of humans (some religions limit it to males).

- Strawson’s concept of moral responsibility yields a compatibilist account of being responsible but one that departs significantly from earlier such accounts in two respects.

- A rapidly expanding body of empirical data on folk intuitions about freedom and responsibility has added fuel to this debate.

- Revisionism about moral responsibility is a matter of degree.

- The future direction of reflection on moral responsibility is uncertain.

References


- CFA Level I Standard 1 (Professionalism) Video Lecture by Mr. Arif Irfanullah. [Video online] Available at: <http://www.youtube.com/watch?v=IBK3U_PG1HY&list=PL346D7ECC82D9213B> [Accessed 28 January 2014].

- CFA Level I Ethics Overview Video Lecture by Mr. Arif Irfanullah. [Video online] Available at: <http://www.youtube.com/watch?v=Qth1CGPPaC4> [Accessed 28 January 2014].
Corporate Governance and Business Ethics

**Recommended Reading**

Self Assessment

1. Which of the following ethics, as opposed to theoretical ethics, examines practical ethical issues those contended by the societies across the globe?
   a. Personal ethics
   b. Professional ethics
   c. Applied ethics
   d. Meta ethics

2. The principal aim of applied ethics is to ________ specific moral problems through the application of ethical theory to the scenarios where conflicting ideas support both sides of the issue.
   a. create
   b. analyse
   c. ignore
   d. overlook

3. Match the following

<table>
<thead>
<tr>
<th>1. Compulsory standard</th>
<th>A. This standard would be defined as the best benchmarking standard available in the market and employees must constant strive to reach up to that level.</th>
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<tbody>
<tr>
<td>2. Ideal standard</td>
<td>B. He believes that professions are occupational fields that can be distinguished in terms of five characteristics</td>
</tr>
<tr>
<td>3. According to American professor in Engineering Prof. Allan Firmage</td>
<td>C. These standards must apply to all grades of employees working for an organisation.</td>
</tr>
<tr>
<td>4. Prof. Ernest Greenwood (1920–2004)</td>
<td>D. A profession can be understood in terms of the attributes and requirements of a professional practice.</td>
</tr>
</tbody>
</table>

a. 1-B, 2-D, 3-A, 4-C
b. 1-A, 2-B, 3-C, 4-D
c. 1-C, 2-A, 3-D, 4-B
d. 1-D, 2-C, 3-B, 4-A

4. __________ ethics could suggest that professionals have their own system of ethics, separate from ordinary ethics.
   a. Professional
   b. Applied
   c. Personal
   d. New

5. Which of the following is statement is true?
   a. Every code of conduct should not go into realm of business ethics of an organisation.
   b. Every code of conduct should go into realm of business ethics of an organisation.
   c. Two codes of conduct should go into realm of business ethics of an organisation.
   d. No code of conduct should go into realm of business ethics of an organisation.
6. Praise and ________ are perhaps the most obvious forms such reactions could eventually resort to.
   a. appraisal
   b. appreciation
   c. moral
   d. blame

7. Who seems to have been the first to construct explicitly a theory of moral responsibility?
   a. Aristotle (384–323 BC)
   b. Prof. Mark Miller
   c. Prof. Ernest Greenwood (1920 – 2004)
   d. American Society of Civil Engineers (ASCE)

8. For some Naturalists, the equation of free will and moral responsibility is driven by their goal of eliminating punishment and what they see as a ‘culture of ________’.
   a. responsibility
   b. moral
   c. hate
   d. vengeance

9. Which of the following seem to naively accepted the ancient religious arguments that free will is an exclusive property of humans (some religions limit it to males)?
   a. Naturalists
   b. Indeterministic
   c. Compatibilist
   d. Consequentialist

10. Which of the following about moral responsibility is a matter of degree?
    a. Naturalists
    b. Revisionism
    c. Compatibilist
    d. Consequentialist
Chapter VIII
Environmental Ethics

Aim
The aim of this chapter is to:

- introduce environment ethics
- explain environment ethics
- explicate the history of environmental ethics

Objectives
The objectives of this chapter are to:

- explain the development of environmental ethics
- elucidate individual living organism
- explicate holistic entities

Learning outcome
At the end of this chapter, you will be able to:

- identify radical ecological ethical theories
- understand earth ethics
- recognise the future of environmental ethics
8.1 Introduction

Humankind’s failure to relate to nature with respect is most clearly reflected in the ongoing environment crisis, which since the industrial revolution has been characterised by massive industrial scale exploitation and the concurrent destruction of natural entities, such as individual’s species and ecosystem. Until recently, people were not aware of, or did not take seriously the harmful effects of economic development on the environment. In recent years, however, due to the warnings rounded by science about an impending ecological imbalance, philosophy became intensively aware of the environment we live in, and much attention has been paid on issues related to it. This emergence of awareness led to development of a new ethical philosophical discipline called ‘Environment Ethics’.

Field of ethics

Ethics is divided into two fields, meta ethics and normative ethics. Meta ethics, also called analytical or critical ethics, systematically studies the meanings of ethical terms and of judgement used in normative ethics, their function, and the means of supporting normative judgements. Normative ethics, also called moral philosophy, is concerned with presenting and justifying a guide to right conduct. It employs such terms as ‘good’, ‘bad’, ‘right’ and ‘wrong’ to express preferences, decisions and choices or to criticise, grade, persuade, praise, blame and encourage. Environmental ethics falls under normative ethics.

8.2 Environmental Ethics

Environmental ethics is relatively a new field of philosophical ethics, concerned with describing the values carried by the non-human natural world and prescribing an appropriate ethical response to ensure preservation or restoration of those values. Environmental ethics is the discipline in philosophy that studies the moral relationship of human beings to, and also the value and moral status of the environment and its non-human contents. In other words, “Environment ethics is theory and practice about appropriate concern for, values in and duties regarding the natural world.” Environmental ethics starts with human concerns for a quality environment and, some thinks this shape the ethics from start to finish. Others hold that beyond inter-human concerns, values are at stake when humans relate to animals, plants, species and ecosystem. According to their vision, humans ought to find nature sometimes morally considerable in itself, and this turns the ethics in new directions.

It is often said to be morally wrong for human beings to pollute and destroy part of natural environment and to consume a huge proportion of the planet’s natural resources. If that is wrong, is it simply because the sustainable environment is essential to human well-being? Or is such behaviour also wrong because the natural environment and its various contents have certain value in their own right so that these values ought to be respected and protected in any case? These are among the questions investigated by environmental ethics.

In the literature of environmental ethics, the distinction between instrumental and intrinsic value has been of considerable importance. The former is the value of things as means to further some ends, whereas the latter is the value of things as ends in themselves regardless of whether they are also useful as means to other ends. As the intrinsically valuable is that which is good as an end in itself, it commonly agreed that something’s possession of intrinsic value generates a prima facie direct moral duty on the part of moral agents to protect it or at least refrain from damaging it.

In the field of environmental ethics, broadly there lie two perspectives. First perspective is called human-centred (anthropocentric) worldview. They assign intrinsic value to human beings alone or they assign a significantly greater amount of intrinsic value to human beings than to any non-human things, such that the promotion of human interests or well being at the expanse of non-human things turns out to be nearly always justified. For example, Aristotle maintains that “Nature has made all things specifically for the sake of man and that the value of non-human things in nature is merely instrumental.” Generally, anthropocentric positions find it problematic to articulate what is wrong with the cruel treatment of non-human animals, except to the extent that such treatment may lead to bad consequences for human beings. Kant (‘Duties to Animal and spirits’, in lecture on Ethics), for instance suggests that cruelty towards a dog might encourage a person to develop a character, which would be desensitised to be cruelty towards humans. From this standpoint, cruelty towards non-human animals would be instrumentally rather than intrinsically wrong. Likewise, anthropocentrism often recognises some non-intrinsic wrongness of anthropogenic environmental devastation. Such destruction might damage the well-being of human beings now and in the future,
since our well-being is essentially dependent on a sustainable environment. This human-centred view prevails in most industrial societies today. According to this view, as the planet’s most important and dominant species we can and should manage the planet mostly for our benefit. Other species have only instrumental value; that is; their value depends on whether they are useful to us or not. The following are the basic beliefs of this worldview:

- We are the planet’s most important species and we are apart from and in charge of the rest of nature.
- There is always more and it’s all for us. Earth has an unlimited supply of resource to which we gain access through use of science and technology.
- All economic growth is good, more economic growth is better, and the potential for economic growth is unlimited.
- A healthy environment depends on a healthy economy.
- Our success depends on how well we can understand, control, and manage the planet for our benefits.

There are several versions of this view. Some people think that economic and population growth is good and more growth is better. There is no serious problem of environment, or if there are, economic growth and technology will fix them. They are called ‘No problem School’.

Another group believes that the best way to manage the planet is through a free market global economy with minimal government interference. Still another group believes that we have serious environmental problem that we must deal with by becoming better and more responsible planetary managers. These people follow the pragmatic principle of enlightened self-interest: Better earth care is better self-care. Many people with this belief adopt a Spaceship-Earth strategy, in which earth is seen as a spaceship—a complex machine that we can understand, dominate, change and manage to prevent environmental overload and provide a good life for everyone. Another group advocates the principle of stewardship in managing the earth. According to this principle, because of our super intellect and power or because of our moral or religious belief, we have an ethical responsibility to manage and care for all species and ecosystem. However, all these views are anthropocentric, which aims for the more and more betterment of human species.

This very anthropocentric view is responsible for the present state of environmental and endangered condition of planet earth and its species. As a reaction to this anthropocentric worldview, emerged the eco-centric or non-anthropocentric view, which further developed as a systematic philosophical discipline namely ‘environmental ethics’. Non-anthropocentrism believes that any human-centred worldview even stewardship is unsustainable. They hold the view that we all should recognise inherent value or intrinsic value of all forms of life, i.e., value regardless of their potential or actual use to us. This means that all species have inherent right to live and flourish or at least to struggle to exist to play their role in evolution.

Non-anthropocentrism tries to establish that all non-human living organs are morally valuable in themselves, as each of them possesses intrinsic value irrespective of valuers. It annihilates moral hierarchy within biotic communities, restores equal moral status and environmental justice, mutual care, love and sympathy. It equally cultivates individual rationality by means of which one can realise that his own self is no longer different from other and every individual self is essentially merged with the self. Thus, self-realisation is the most important key to understanding nature.

Proponents of eco-centric worldview believe that as long as we see ourselves as the ‘top-dog’ species, we will continue to eliminate species that are not useful to us instead of recognising biodiversity as a vital element of earth capital for all life. They also believe that any human-centred worldview will fail because it wrongly assumes that we have or can gain enough knowledge to become manager of man. In the words of Aldo Leopold “We are only fellow voyagers with other creatures in the odyssey of evolution.” Eco-centric world view calls for us to work with rest of nature by learning and using mechanism that nature has evolved for promoting sustainability and adaptability.
The following are eco-centric beliefs which are the opposite of the anthropocentric worldview beliefs:

- Nature exists for all Earth’s species not just for us, and we are not apart from or in charge of the rest of nature. We need the earth, but the earth does not need us.

- There is not always more, and it’s not all for us. Earth’s resources are limited, should not be wasted, and should be used sustainably for us and all species.

- Some forms of economic growth are beneficial and some are harmful. Our goals should be to design economic and political system that encourage earth-sustaining forms of growth and discourage or prohibit earth degrading forms, and to see that the benefits of such growth are distributed equitably among all people (social and economic justice) and sexes (gender justice), and across generations (intergenerational justice).

- A healthy economy depends on a healthy environment. Our survival, life quality, and economies are totally dependent on the rest of nature.

- Our success depends on learning to cooperate with one another and with the rest of nature instead of trying to dominate and manage earth for our own use. As nature is so incredibly complex and always changing, we will never have enough information and understanding to manage the planet.

8.3 History of Environmental Ethics

The notion of eco-centric ethics or environmental ethics has gained prominence recently among many environmentalists, but its ongoing go back centuries. Environmental ethics as a discipline evolved in west, but environmental values, and concern for protection and urge to live in harmony can be traced from eastern world also. One of the oldest religion of east, Hinduism provides a worldview with regard to the ecological situation based on the premise that mankind is an integral part of nature itself linked to the rest of creation by an indissoluble bounds. Prayer for peace in Yajurveda is the embodiment of environment ethics, “Supreme Lord, let there be peace in the sky and in the atmosphere, peace in the plant world and in the forests; let the cosmic powers be peaceful, let Brahman be peaceful; let there be undiluted and fulfilling peace everywhere.” Eastern religions Hinduism, Jainism, Buddhism, Taoism, Confucianism, Shintoism, etc., are enshrined with environmental values, and promote harmony with nature world. St. Francis of Asisis (1181-1126) espoused a philosophy akin to the eco-centric ethic. He specially considered all animals as integrated components of divine creation. According to him, ‘wildlife has the right to exist independent of any human purpose. During St. Francis’s century, however, such concepts were largely ignored or chastised.

Henry David Thoreau (1817-1862), the father of Limnology, the transcendentalist, also professed a variety of eco-centric ethics. He built a cabin on Walden Pond in Massachusetts and lived a simple life for two years. There, he viewed nature as a single living organic entity with all living organisms related to each other. In his work, ‘Walden’ he urged his readers to recognise and learn to live within environmental guidelines.

Although nature was the focus of much nineteenth and twentieth century philosophy, contemporary environmental ethics emerged as an academic discipline in the 1970s. This emergence was no doubt due to the increasing awareness in the 1960’s of the effects that technology, industry, economic expansion and population growth having on the environment. The development of such awareness was aided by the publication of two important books at this time. Rachel Cason’s ‘Silent Spring’ first published in 1962, alerted readers to how the widespread use of chemical pesticides was posing a serious threat to public health and leading to the destruction of wildlife. Of similar significance was Paul Ehrlich’s book, ‘The population Bomb’ (1968), which warned of the devastating effects of spiralling human population on planet’s resources.

An intellectual climate had developed in the last few years of the 1960s in large part because of the publication of two papers in ‘Science’ Lynn White’s, ‘The historical roots of our ecological crisis’ (March, 1967) and Garrett Hardin’s, ‘The Tragedy of the Commons’ (Dec 1968). In his paper, White argued that the main strands of Judoc- Christian thinking had encouraged the over-exploitation of nature by maintaining the superiority of humans over all other forms of life of earth and by depicting all of nature as created for the use of humans. White’s thesis is widely discussed in theology, history and has been subject to some sociological testing as well as being regularly discussed by philosophers. Central to the rationale for his thesis were the works of the Church Father’s and the Bible itself, supporting the anthropocentric perspective that humans are the only thing that matter on Earth. Consequently, they may utilise and consume everything else to their advantage without any injustice.
In addition, White also stated that some minority traditions within Christianity (e.g., the views of St. Francis) might provide an antidote to the arrogance of a mainstream tradition steeped into anthropocentrism. Around the same time ‘Population Bomb’, (1968) was published. Most influential with regard to this kind of thinking, however, was an essay in Aldo Leopold’s A Sand Country Almanac, “The Land Ethic” in which Leopold explicitly claimed that the roots of ecological crisis were philosophical. Although originally published in 1949, ‘Sand Country Almanac’ became widely available in 1970 in a special Sierra Club/Ballantine edition in which included essays from a second book, ‘Round River’. The sense of environmental crisis stimulated by those and other popular works was intensified by NASA's production and wide dissemination of a particularly potent image of the earth from space taken at Christmas, 1968 and featured in the ‘Scientific American’ in September 1970. Here, plain to see, was a living, shining planet voyaging through space and shared by all of humanity, a precious vessel vulnerable to pollution and to the overuse of its limited capacities. In 1972, a team of researcher at MIT led by Dennis Meadows published the ‘Limits to Growth’ study, a work that summed up in many ways the emerging concerns of the previous decade and sense of vulnerability triggered by the view of the earth from space. In commentary of the study the researcher wrote, “We affirming finally that any deliberate attempt to reach a rational and enduring state of equilibrium by planned measures, rather than by chance or catastrophe, must ultimately be founded on a basic change of value and goals at individual, national and world levels.”

The call for a basic change of values in connections to the environment (a call that could be interpreted in terms of either instrumental or intrinsic value) reflected a need for the development of environmental ethics as a new sub division of philosophy. Throughout most of the decade philosophers sat on the sidelines trying to determine what a field called environmental ethics might look like.

William Blackstone at the University of Georgia organised the first philosophical conference in 1972. The proceedings were published as ‘Philosophy and Environmental Crisis’ in 1974 which included Pete Gunter’s first paper on ‘The Big Thicket. In 1972, a book called ‘Is it too late? A Theology of Ecology’ written by John B. Cobb was published. It was the first single authored book written by a philosopher. In 1973, an Australian philosopher Richard Routley (Now Sylvan) presented a paper at the 15th World Congress of Philosophy ‘Is there a need for a new Environmental Ethics.’ In 1975, environmental ethics came to the attention of mainstream philosophy with the publication of Holmes Rolston III’s, paper “Is there an Ecological Ethics?” Arne Naess, Norwegian philosopher and the founding editor of the journal ‘Inquiry’, authored and published a paper in Inquiry, ‘The shallow and the Deep, Long-Range Ecology Movement’ in 1973, which was the beginning of the deep ecology movement. Prominent writers in this movement include George Session, Bill Devall, Warwick Fox, and Max Oelschaeger.

Throughout the 1970s ‘Inquiry’ was the primary philosophy journal that dealt with environmental ethics. In 1979, Eugene C. Hargrove founded the journal ‘Environment Ethics’, which name became the name of the field. The first five years of the journal were spent mostly arguing about rights for nature and the relationship of environmental ethics and animal rights/animal liberation. Rights lost and animal welfare ethics were determined to a separate field. Animal rights has since developed as a separate field with a separate journal, first, ‘Ethics and Animals’, which was later superceded by ‘Between the Species’.

John B. Cobb published another book in the early 1980s ‘The liberation of life’ with co-author Charles Birch. Robin Attfield, a philosopher in Wales, wrote a book called ‘The ethics of Environmental Concern’. It was the first full length response to Passmore. An anthology of papers, ‘Ethics and the environment’ was edited by Donald Scherer and Tom Attig.

In the 1980s, a second movement, eco-feminism was developed. Karen Waren is the key philosopher, although the eco-feminism movement involves many thinkers from other fields. It was then followed by a third, social ecology based on the views of Murray Bookchin. An important link between academics and radical environmentalists was established with the creation of Canadian deep ecology journal ‘The Trumpeter’. In 1989, ‘Earth Ethics Quarterly’ was begun as a more popular environmental publication. Originally intended primarily as a reprint publication, now as a publication of the ‘Centre for respect for life and Environment’, it is focused more on international sustainable development. The 1990s begin with the establishment of the ‘International Society for Environmental Ethics’, which was founded largely through the efforts of Laura Westra and Holmes Ralston III. It now has members throughout the world. In 1992, a second referred philosophical journal dedicated to environmental ethics, ‘Environmental values’ published its first issue in England. In 1966, a new journal was established at the University of Georgia, ‘Ethics and the Environment.’ In 1997, a second international association was created ‘The International Association for Environmental Philosophy’, with an emphasis of environmental phenomenology.

8.4 Development of Environmental Ethics

The field of environmental ethics concerns to outline our moral obligation. The most fundamental question that must be asked when regarding a particular environment ethic is simply ‘what obligation do we have concerning the natural environment. If the answer is simply that we, as human beings, will perish if we do not constrain our action towards nature, then the ethics is considered to be anthropocentric. In one sense, all ethics must be considered anthropocentric. After all, only human beings can reason about and reflect upon ethical matters, thus, giving all moral debate a definite ‘human centeredness’. While the history of western philosophy is dominated by this anthropocentric ethical framework, that grants moral standing solely to human beings, it has come under considerable attack from many environmental ethicists. Such thinkers have claimed that ethics must be extended beyond humanity, and moral standing should be accorded to the non-human natural world. Some have claimed that this extension should run to sentient animals, other to individual living organisms and still others to holistic entities, such as river, species and ecosystems. Under these ethics, we have obligations in respect of the environment because we actually owe things to the creatures or entities within the environment themselves. Different philosophers have given different answers to these fundamental questions, which has led to the emergence of quite different environmental ethics. The following section examines the prominent accounts for moral standing within environmental ethics, together with the implication to each.

8.5 Human Beings

Under this section comes the anthropocentric ethics which claims that people are both the subject and object of ethics. Humans can have no duties to flora and fauna and ecosystem only. Anthropocentrists may wish to save these things for the benefits they bring. Quite simply then, we possess obligation to respect the environment for the sake of human’s well-beings and prosperity. The sentiments of John Passmore are probably typical of this narrower view. It is one thing to say that it is wrong to treat animals cruelly, and quite another to say that animals have rights.

Despite the human-centeredness, anthropocentric environmental ethics has nevertheless played a part in the extension of moral standing. This extension has not been to the non-human natural world though, but, instead, to human beings who do not yet exist. The granting of moral standing to future generation has been considered because of the fact that many environmental problems, such as climate change and resource depletion will affect future generation much more than they affect present ones. In light of these facts, some philosophers have founded their environmental ethics on obligation to the future generations. In this sense, our obligations lie with ensuring that we do not prevent future generations from meeting their basic needs. This, in turn, forces us to consider and appropriately revise our levels of pollutions, resource depletion, and climate change and population growth. Despite this extension of moral standing, most environmental philosophers feel that such anthropocentric environmental ethics does not go far enough, and want to extend moral standing beyond humanity. Only by doing this, such thinkers argue that we can get beyond the narrow and selfish interests of humans, and treat the environment and its inhabitants with the respect they deserve.
**8.6 Animals**

Ethics is for people, but is ethics only about people? Wild animals do not make man the measures of things at all. There is no better evidence of non-human values and valuers than spontaneous wild life, born free and on its own. Animals hint and haul, find shelter, seek out their habitats and mates, care for their young, and flee from threats. They suffer injury and lick their wounds. Animals maintain a valued self-identity as they cope through the world. They defend their lives because they have a good of their own. There is somebody there behind fur or feathers.

An animal values its own life for what it is in itself, without further contributory reference, although of course it inhabits an eco-system in which its life-support depends. Animals are valuable, able to value things in their world, their own life intrinsically and their resource instrumentally. Several philosophers agree that moral standing should be extended to include animals and an animal welfare ethic or some prefer to say an animal rights ethic.

Peter Singer and Tom Regan are the most famous proponents of the view that we should extend moral standing to other species of animals. While both develop quite different animal ethics, their reasons for according a moral status to animals are fairly similar. According to Singer, the criterion to moral standing is sentience: the capacity to feel pleasure and pain. For Regan, on the other hand, moral standing should be acknowledged in all subjects-of-a-life: that is those beings with beliefs, desire, perception, memory, emotions, a sense of future, and the ability to initiate action. Regan and Singer give tightly different criteria for moral standing. Both of them place a premium on a form of consciousness.

For Singer, if any entity possesses the relevant type of consciousness, then that entity should be given equal consideration when we formulate our moral obligations. The point is not that every sentient being should be treated equally, but that it should be considered equally. In other words, the differences between individuals, and thus, their different interests should be taken into account. Singer then feeds his principle of equal consideration into a utilitarian ethical framework, whereby the ultimate goal is to bring about the greatest possible satisfaction of interests.

For Tom Regan, all entities that are subject-of-a-life ‘possess inherent value’. This means that such entities have a value of their own, irrespective of their good for other beings or their contribution to some ultimate ethical norm. In effect then, Regan proposes that there are moral limits to what one can do to a subject-of-a-life. This position stands in contrast to Singer, who feeds all interests into the utilitarian calculus and bases our moral obligation on what satisfies the greatest numbers.

It can be concluded from the above perspective that animal welfare is relevant to environmental ethics because animals exist within the natural environment and thus, form part of environmental concerns. However, extending moral standing to animals also leads to the formulation of particular types of environmental obligations. Essentially, these ethics claim that when we consider how our actions impact on the environment, we should not just evaluate how these affect humans (present or future), but also how they affect the interest and rights of animals.

**8.7 Individual Living Organism**

A bio-centric ethics asks about appropriate respect towards all living things, not only the wildlife and farm animals, but now the butterflies and the sequoia tress. Otherwise, most of the biological world has not yet taken into account: lower animals, insects, microbes, and plants. Over 96 percent of species are invertebrates or plants; only tiny fractions of living organisms are sentient animals. Considering plants makes the difference between biocentrism and animal ethic clear. For some environmental philosophers, extension of moral standing merely to animals is not sufficient rather, it should be extended beyond conscious life to include individual living organism such as tree. According to them, we cannot rely on intuitions to decide who or what has moral standing. For this reason, a number of philosophers have come up with arguments to justify assigning moral standing to individual living organism. One of the earliest philosophers to put such an argument was Albert Schweitzer. His influential reverence for life claims that all living thing have a will to live and that humans should not interfere with or extinguish this will. In the words of Schweitzer, “Just as in my own will to live there is a yearning for more life, and for that mysterious exaltation of the will-to-live which is called pleasure, and terror in the face of annihilation and that injury to the will-to-live which is called pain; so the same obtains in all the will-to-live around me, equally whether it can express itself to my comprehension or whether it remains unvoiced. Ethics thus consists of the necessity of practicing the same reverence for life toward all as towards one’s own. That is the much needed fundamental principle of morality. It is good to maintain and cherish life, it is evil to destroy and check life.”
However, while it is clear that all living organisms struggle for survival, it is simply not true that they ‘will’ to live. This, after all, would require some kind of conscious experience, which many living things lack, however, perhaps what Schweitzer was getting at was something like Paul W. Taylor and more recent claim that all living things are teleological centres of life. For Taylor, this means that living things have a good of their own that they strive towards, even if they lack awareness of this fact. This good is the full development of an organism’s biological power. In similar arguments to Regan’s, Taylor claims that because living organisms have a good of their own, they have inherent values; i.e., value for their own sake, irrespective of their value to other beings. It is this value that grants individual living organism moral status, and means that we must take the interest and needs of such entities into account when formulating our moral obligations.

Christopher Stone, a Professor of law at the University of Southern California proposed that trees and other natural objects should have at least the same standing in law as corporations. He reasoned that if tree, forests and mountains could be given standing in law then they could be represented in their own right in the courts by groups. Moreover, like any other legal person, these natural things could become beneficiaries of compensation, if it could be shown that they had suffered compensatable injury through human activity.

A question arises that we humans require the destruction of many living organisms simply in order to live, how are we then formulating any meaningful moral obligation. We need to walk, eat, shelter, and clothe ourselves, all of which usually, involve harming living beings. Schweitzer answers that we can only harm or end the life of a living entity when absolutely necessary. On clearing about necessary condition, Taylor points out as self defense, basic needs. When basic interests clash, humans are not required to sacrifice themselves for the sake of others.

8.8 Holistic Entities

Aldo Leopold, a forester ecologist, is the main influence on those who proposes holistic ethics. He claimed famously, “A thing is right when it tends to preserve the integrity, stability and beauty of biotic community. It is wrong when it tends otherwise. ‘The land is a community’, is the basic concept of ecology, but that land is to be loved and respected is an extension of ethics.” In a holistic ethics, this ecosystematic level in which all organisms are embedded also counts morally in some respect more than any of the component organisms, because the systematic processes have generated, continue to support, and integrate tens of thousands of member organisms. The appropriate unit for moral concern is the fundamental unit of development and survival. That, we were just saying, is species lines. However, a species is what it is, where it is, encircled by ecology.

According to Leopold, land is not merely soil. Instead, land is a fountain of energy, flowing through a circuit of soils, plants and animals while food chain conduct the energy upwards from the soil, death and decay returns the energy back to the soil. Thus, the flow of energy relies on a complex structure of relation between living things. While evolution gradually changes these relations, Leopold argues that man’s intervention have been much more violent and destructive. In order to preserve the relations with the land, Leopold claims that we must move towards ‘land ethic’, thereby granting moral standing to the land community itself, not just its individual members.

Loeplold’s idea that the land as a whole is an object of our moral concern also stimulated writers like Eric Katz, Andrew Brennaran to argue for certain moral obligation towards ecological not just their individual constituents. The U.S. based theologian and environmental philosopher; Holmes Rolston III argued that species protection was a moral duty. It would be wrong, he maintained, to eliminate a rare butterfly species simply to increase the monetary value of specimens already held by collectors. Species are intrinsically valuable. They are usually more valuable than individual specimen, since the lost of a species is a loss of genetic possibilities and the deliberate destruction of a species would show disrespect for the very biological process, which make possible the emergence of individual living things.

J. Baird Callicott advocated a version of land-ethical holism which takes Leopold’s statement “a thing is right …..” In this theory, the earth’s biotic community per se is the sole locus of intrinsic value, here as the value of its individual members is merely instrumental and dependent on their contribution to the integrity, stability and beauty of the larger community. Thus, on the whole, according to bio-centric ethics, our moral obligation lies in maintaining and not disturbing the integrity and stability of larger community by our actions.
8.9 Earth Ethics

The astronaut Michael Collins recalled being, “I remember so vividly. What I saw when I looked back at my fragile home—a glistening, inviting beacon, delicate blue and white, a tiny outpost suspended in a black infinity? Earth is to be treasured and nurtured, something precious that must endure.” The UN Secretary-General, Boutros Boutros Ghali, closed the Earth summit, “The spirit of Rio must create a new mode of civic conduct. It is not enough for man to love his neighbour he must learn to love his world.” Earth is not mere a big resource to be exploited for human needs, nor a pie to be divided up for human consumption. Rather, Earth is a precious thing in itself because it is home for us all; Earth is to be loved, as we do a neighbour for an intrinsic integrity. The centre of focus is not people, but the biosphere.

The most prominent philosopher, who proposed highest moral standing to earth itself, is James Lovelock, who proposed ‘Gaia Hypothesis’. He first exposed his idea in 1979 in his book, ‘Gaia, a new look at life on Earth’. The Gaia theory states that the biosphere of this planet has most or all of the essential characteristics of a living organism. These characteristics are responses to stimuli, metabolism, biological development and, most importantly, homeostasis. The fifth characteristic, reproduction, may be or may not be evident. Nevertheless, Gaia model represents the planet as a super organism. It also implies that not only do living organisms modify their non-living environment, but both of them evolve together as a unity.

Lovelock discovered Gaia from outer space when he saw the Earth from the perspective of an ET looking for evidence of life. He thought that what he is seeing is not so much a planet adorned with diverse life form, but a planet transfigured and transformed by a self-evolving and self-regulating living system. By nature of its activity, he named that being Gaia, after the Greek goddess, which drew the living world forth from chaos. The myriad different cell colonies which make up organs and bodies, the life forms of earth in their diversity co-evolving and contribute interactively to produce and sustain the optimal conditions for the growth and prosperity not of themselves, but of the larger whole, Gaia. The very make up of the atmosphere, seas, and terrestrial crust is the result of radical intervention carried out by Gaia through the evolving diversity of living creatures.

James Lovelock proves through his theory the importance of whole earth as a super living organism, and that our moral consideration should be extended up to the Earth itself. Eco-centric views emphasise our obligations towards Gaia’s health by invoking the intrinsic value of a complex system like Gaia and by recognising that Gaia as long-lived super organisms has great relative worth than a single species like Homo sapiens. Under the eco-centric view, all species carry equal worth a priori, but every species is dispensable to Gaia, whereas a healthy Gaia is absolutely indispensable for the flourishing of any species.

As Gaia is identical with the global ecosystem, its biota and abiotica, we are under the moral obligation to apply the criteria that ecologists have established for the health of smaller ecosystems, i.e., maintain species diversity, productivity and the system’s homeostatic capacity. As Lovelock said, “Earth does not belong to us, rather we belong to it. We belong on it. Earth is really the relevant survival unit. The Gaian ethics may facilitate the task of converting destructive human activities to constructive and corporate behaviour.

8.10 Radical Ecological Ethical Theories

There are some philosophers who perceive our obligation towards environment beside in terms of extending moral standing. They do not find extension of moral standing sufficient to resolve environmental crisis. They argue that a broader philosophical perspective is needed, requiring fundamental changes in both our attitude to and understanding of reality. For radical ecologist, ethical extensionism is inadequate because it is stuck in traditional ways of thinking that led to these environmental problems in the first place. They argue that ethical extensionism too is human-centred, because it takes human beings as the paradigm example of entities with moral standing and then extends outwards to those things considered sufficiently similar. These radical ecologies do not confine themselves solely to the arena of ethics. Instead, they demand fundamental changes in society and its institution. In other words, these ideologies have a distinctively political element, requiring us to confront the environmental crisis by changing the way we live and function, both as a society and as an individual.
8.10.1 Deep Ecology

This philosophical school was founded by Norwegian philosopher Arne Naess in the early seventies with his distinction between shallow and deep ecology. The shallow ecology movement, as Naess calls it, is the fight against pollution and resource depletion, the central objective of which is the health and affluence of people in the developed country. The deep ecology in contrast endorses biospheric egalitarianism, the view that all living things are alike in having value in their own right, independent of their usefulness to others. It recognises the fundamental interdependence of all phenomena and the fact that as individuals and societies, we are all embedded in (and ultimately dependents) the cyclical process of nature. Deep ecologists advocate the development of a new eco-philosophy or ecosophy to replace the destructive philosophy of modern industrial society. Arne Naess and George Sessions have compiled the following list of eight principles or statement that is basic to deep ecology:

- Well being and flourishing of human and nonhuman life on earth have value in themselves (synonyms: intrinsic value, inherent worth)
- These values are independent of the usefulness of the non-human world for human purposes.
- Richness and diversity of life forms contribute to the realisation of these values and are also values in themselves.
- Humans have no right to reduce this richness and diversity except to satisfy vital needs.
- The flourishing of human life and cultures is compatible with a substantially smaller population. The flourishing of non-human life requires smaller human population.
- Present human interference with the non-human world is excessive and the situation is rapidly worsening.
- Policies must therefore be changed. These policies effect basic economies, technological and ideological structures. The resulting state of affairs will be deeply different from the present.
- The ideological changes will mainly that of appreciating life quality (dwelling in situations of inherent values) rather than adhering to an increasingly higher standard of living. There will be a profound awareness of the difference between bigness and greatness.

Those who subscribe to foregoing points have an obligation directly or indirectly to try to implement the necessary changes.

Naess’s ecosophy involves just one fundamental ethical norm ‘Self realisation’. For Naess, this norm involves giving up a narrow egoistic conception of the self in favour of a wider more comprehensive self (hence the deliberate Capital ‘S’). Moving to this wider ‘Self’ involves recognising that as human beings we are not removed from nature, but are interconnected with it. Recognising our wider self, thus, involves identifying ourselves with all other life forms on the planet. The Australian philosopher Warwick Fox has taken this theme of self-realisation in his own eco-philosophy, ‘transpersonal ecology’. Fox does not regard environmental ethics to be predominantly about formulating our moral obligation concerning the environment, but instead views it about the realisation of an ecological consciousness. Thus, for Naess, once the appropriate consciousness is established, one will naturally protect the environment and allow it to flourish, for that will be part and parcel of the protection and flourishing of oneself.

A radical ecological thinker, Mahatma Gandhi’s ideas were quite akin to deep ecology. Nature to him was the outer expression of the all-pervasive living reality, which means God. He said “God manifests himself in innumerable forms in the universe and every such manifestation command my spontaneous reverence” He was quite sensitive to the charms of nature. He viewed that everything living and non-living is vibrating with life. He advocated a creative harmony between individual communities and natural world. He advocated that it is the task of human beings to realise that only a violent attitude towards life destroys the power of the earth. So, as a remedial measure, Gandhi told to follow a non-violent way of life, a unique and valuable concept which needs to be expanded to all living and nonliving beings. Hence, his vision was of a non-violent eco-friendly world order.

He echoed his principle of deep ecology, when he said that nature has given enough to satisfy everyone’s need, but not greed. Unsatisfied desire, resulting into increasing imbalance, environmental degradation, fast vanishing flora and fauna, explosion of population are the outcome of the greed of the modern homo-sapiens. He himself practised nonviolence throughout his life and told that as it is not possible for a human being to create life, he is in no way justified to destroy any life.
8.10.2 Social Ecology

Social ecology shares with deep ecology the view that the foundations of environmental crisis lie in the dominant ideology of modern western society. Thus, just as deep ecology, social ecology clears that in order to resolve the crisis, a radical overhaul of this ideology is necessary. Indeed, domination is the key theme in the writing of Murray Bookchin, the most prominent social ecologist. For him, environmental problems are directly related to social problems. In particular, Bookchin claims that the hierarchies of power prevalent within modern societies have fostered a hierarchical relationship between human beings and natural world. Indeed it is the ideology of free market that has facilitated such hierarchies, reducing both human beings and natural world to mere commodities.

Bookchin argues that the liberation of both human and nature is actually dependant on one another. This argument is quite different from Marxist thought which recognises men’s freedom dependent on the complete domination of humans from nature that is prevalent in capitalist ideology. Instead, social ecology argues that human must recognise that they are part of nature, not distinct or separate from it. It suggests that then human societies and human relations with nature can be informed by the non-hierarchical relations found within the natural world. Like in ecosystems, there is no species more important than other; instead relationships are mutualistic and interrelated. This interdependence and lack of hierarchy in nature provide a blueprint for a non-hierarchical human’s society.

On how such transformed society will look like? Bookchin explains that such transformation must take place within smaller local communities. Such communities will be based on sustainable agriculture, participation through democracy, and of course freedom through non-domination. Not only then does nature help in cementing richer and more equal human communities, but transforming societies and fostering a more benign relationship with nature. This latter point also illustrates Bookchin’s optimistic view of humanity’s potential. After all Bookchin does not condemn all of humanity for causing the ecological crisis, instead it is the relationship with societies that are to blame. Bookchin suggests that we can choose to put ourselves at the service of natural evolution, to help in maintaining complexity and diversity diminish suffering and reduce pollution. Bookchin’s social ecology recommends that we use our gifts of sociability, communication and intelligence as if we were ‘nature rendered conscious’. Exploitation of nature should be replaced by a richer form of life devoted to nature’s preservation.

Indian environmental thinker, Ramchandra Guha also expressed his ideas akin with social ecology. He supported the idea of social change to solve the eco-crisis. He said that our historical experience of different societies shows that there are always exemplary individuals who in their own lives, through thinking, reflection and experience have undertaken value changes and a spiritual transformation in their attitude towards nature and the non-human.

8.10.3 Eco-feminism

Like social ecology, eco feminism also points to a link between social domination and the domination of the natural world. Like both deep ecology and social ecology, eco feminism calls for a radical overhaul of the prevailing philosophical perspective and ideology of western society.

By the mid 1970, feminist writer had raised the issue of whether patriarchal modes of thinking encouraged not only widespread inferiorising and colonising of women, but also of people of colour, animals and nature. Sheila Collins argued that male-dominated culture or patriarchy is supported by four interlocking pillars: sexism, racism, class exploitation and ecological destruction. Yenstra King, an eco-feminist says that domination of women by men is historically the original form of domination in human society, from which all other hierarchies of rank, class and political power flow. Human exploitation of nature may be seen as a manifestation and extension of the oppression of women, in that it is the result of associating nature with female, which had been inferiorised and oppressed by the male dominating culture. Val Plumood and Karen J. Warren are considered prominent eco-feminist thinkers. Like deep ecology and social ecology, eco-feminism also believes that to resolve environmental problems we face and the system of domination in place; it is the consciousness and philosophical outlook of individual that must change.

Deep Ecology, feminism and social ecology have had a considerable impact on the development of political positions in regard to the environment. Apart from their radical ecological theories, there are some other radical ideas, which present their ideas relevant to the development of ecological ethics. One of them is Eucharistic ecology, which believes that this planet is a God’s gift. It perceives earth as Eucharistic planet, which is structured as intimate self-
sharing. It is a great process, a circulation of living energies, in which the real presence of the absolute is discerned. Never holding still, continually passing away from moment-to-moment, it is shining face of the eternal. It is living as an integral body, as the glory body of the real. In short, it perceives the world as the real presence of absolute one, the God.

Similar to Eucharistic ecology is the ‘Pantheism’, which believes in the oneness of God and Nature. This doctrine identifies the deity with various forces and working of nature. It believes that God is identical with the universe. All is God and God is all. The universe taken as a whole is God. God and nature are synonymous, two for the same thing. Pantheism with its idea of oneness of God and nature instills a reverence for nature, which can help in reversing the ecologic crisis.

The variety of approaches to environment ethics described in this chapter indicates the diversity and complexity of environmental ethics. All these approaches to ethics formed in current general ethical theories have been applied with environmental ethics. In addition, considering the possible ethical significance of grouping, such as eco-system and the ideas such as diversity, has led to the development of largely new ethical approaches suggested by Collicot or developed out of Gaia hypothesis. The environmental problems of the present have drawn attention to the insights that ethical questions are raised by human behaviour towards not only non-human individuals, but towards ecosystem, species and biosphere itself. Deciding what sort of ethical response is appropriate to such questions is the task of environment ethics. The importance of such responses is beyond doubt.

8.11 The Future of Environmental Ethics

Given the increasing concern for the environment and the impact that our action have upon it, it is clear that the field of environmental ethics is here to stay. There are evidences for future development in various aspects. First of all, environmental ethics needs to be and will be informed by changes in the political efforts to ameliorate environmental problems. Environmental ethics is concerned with formulating our environmental moral obligations. Realising this imminent danger of the environholocaust, there has been an awakening and a new world order has compelled itself to deliberate how best one can maintain, upgrade and improve the environment with judicious utilisation of this treasure, for the benefit of mankind. In this context, the last decade has witnessed an explosion in the structural and functional capabilities of non-government organisations. It is a sign of relief that various efforts are being taken at global-level by these NGOs. International organisations provide an essential forum for International cooperation in relation to environmental issues. In this context, they have two important roles to play, environmental policy-making and the development of international environmental laws. It is important to observe, however, that these two roles are distinct and that the powers of particular organisations in regard to each function will vary. While it is now common practice for a wide range of international organisations to develop environmental policies, but, the development of law is usually only one element, which does not fall within the powers of organisations. Here, the environmental legislation adopted in various countries plays a vital role for the conservation of environment, i.e., more than two-dozen laws protect India’s environment. They cover all aspects of the environment from pollution to conservation, from deforestation to nuclear waste.

Ethicists and environmentalists must also propose more alternatives and better means of resolving the problem we face, and the environmental movements are providing a significant platform for the same. The environmental movements advocates for the protection, sustainable management and restoration of the natural environment in an effort to satisfy human needs, including spiritual and social needs, as well as for its own sake. The movements are united by a reverence for the natural world, a commitment to maintain the health or natural systems and in its recognition of humanity as a part of and not separate to ecosystems. Some significant movements, i.e., Green Peace, Chipko, Save Narmada, etc., were organised and represented by the common mass resulting in some important summits and treatise for the environmental conservation. Earth summit and Kyoto Protocol are some to name.

Once, it is recognised that we have environmental obligations; all areas of ethics are affected, including just war theory, domestic distributive justice, global distributive justice, human rights theory and global ethics. Global ethics deals with the moral questions that arise from globalisation. Some of the most pressing of these arise from the great systematic disparities of wealth, health, longevity, security, and freedom between the North and South. What obligations have individuals and governments in the North to improve the lives of people in the South? How might
international trading arrangements be made fairer? How might military intervention be better regulated? How might the local tyrannies of warlords or criminal gangs be undone? How far must the ways of life of individuals change for the sake of reversing climate change? In nutshell global ethics can be summarised as under:

- Culture of nonviolence and reverence for life.
- Culture of solidarity and just economic order.
- Culture of tolerance and life of truthfulness.
- Culture of equal rights and partnership between men and women.

Finally, environment ethics of course is informed by our scientific understanding of the environment, whether it is changes in our understanding of how eco-systems work, or changes in the evidence concerning the environmental crisis. Here, environmental education will have to be potential Instrumental for the common awareness. The academic programme should be planned in such a way as to meet the changing needs of the country. We have seen agriculture and technological revolution with their consequences. Now it is high time when we need an educational reform based on environmental education. The behaviour of entire society towards the biosphere must be transformed if the achievement of conservation objectives is to be assured. A new ethics, embracing plants and animals as well as people, is required for human societies to live in harmony with the natural world, on which they depend for survival and well-being. The long-term task of environmental education is to foster or reinforce attitudes and behaviour compatible with this new ethic. The objective of environmental education can be broadly classified as under:

- To create awareness and impart knowledge as also attempt to change the attitude of individual and social groups towards environment and its degradation.
- To help individuals and social groups to acquire skills to evaluate and solve the environmental problems confronting the society through active participation of the members. To achieve these objectives, education can be imparted at two levels, the formal and the informal level.
- To promote formal and non-formal education related to the environment by implementing the world conservation strategy as follows:
  - By promoting the inclusion of environmental objectives within ongoing educational programmes and projects; and developing new projects.
  - By encouraging public participation in environmental issues
  - By facilitating communication within the professional community concerned.
- To train specialist involved in management and decision-making related to conservation:
  - By promoting and developing training programmes for natural resources managers.
  - By supporting the development of a network of wildlife and parks training centres for developing countries.
  - By assisting government departments to meet training needs.
Summary

- Ethics is divided into two fields, meta ethics and normative ethics.
- Environmental ethics is the discipline in philosophy that studies the moral relationship of human beings to, and also the value and moral status of the environment and its non-human contents.
- Environment ethics is theory and practice about appropriate concern for, values in and duties regarding the natural world.
- In the literature of environmental ethics, the distinction between instrumental and intrinsic value has been of considerable importance.
- Non-anthropocentrism believes that any human-centred worldview even stewardship is unsustainable.
- The notion of eco-centric ethics or environmental ethics has gained prominence recently among many environmentalists, but its ongoing go back centuries.
- The field of environmental ethics concerns to outline our moral obligation.
- Peter Singer and Tom Regan are the most famous proponents of the view that we should extend moral standing to other species of animals.
- A bio-centric ethics asks about appropriate respect towards all living things, not only the wildlife and farm animals, but now the butterflies and the sequoia tress.
- Aldo Leopold, a forrest ecologist, is the main influence on those who proposes holistic ethics.
- Lovelock discovered Gaia from outer space when he saw the Earth from the perspective of an ET looking for evidence of life.
- Deep ecologists advocate the development of a new eco-philosophy or ecosophy to replace the destructive philosophy of modern industrial society.
- Naess’s ecosophy involves just one fundamental ethical norm ‘Self realisation’.
- Social ecology shares with deep ecology the view that the foundations of environmental crisis lie in the dominant ideology of modern western society.
- Like social ecology, eco feminism also points to a link between social domination and the domination of the natural world.
- Global ethics deals with the moral questions that arise from globalisation.

References


Recommended Reading

Self Assessment

1. Environmental ethics starts with _________ concerns for a quality environment and, some thinks this shape the ethics from starts to finish.
   a. moral
   b. human
   c. business
   d. ethical

2. Non-anthropocentrism believes that any human-centred worldview even stewardship is _____________.
   a. sustainable
   b. valid
   c. unsustainable
   d. valued

3. Match the following
   
   | 1. St. Francis of Asisis (1181-1126) | A. The father of Limnology, the transcendentalist, also professed a variety of eco-centric ethics. |
   | 2. Henry David Thoreau (1817-1862) | B. This philosophical school was founded by Norwegian philosopher Arne Naess in the early seventies. |
   | 3. Deep Ecology | C. Like social ecology, this also points to a link between social domination and the domination of the natural world. |
   | 4. Eco feminism | D. He espoused a philosophy akin to the eco-centric ethic. |

   a. 1-D, 2-A, 3-B, 4-C
   b. 1-A, 2-B, 3-C, 4-D
   c. 1-B, 2-C, 3-D, 4-A
   d. 1-C, 2-D, 3-A, 4-B

4. Which of the following is also called analytical or critical ethics?
   a. Normative ethics
   b. Meta ethics
   c. Professional ethics
   d. Personal ethics

5. Which of the following falls under normative ethics?
   a. Professional ethics
   b. Personal ethics
   c. Meta ethics
   d. Environmental ethics

6. Which of the following statement is true?
   a. The appropriate unit for business concern is the fundamental unit of development and survival.
   b. The inappropriate unit for moral concern is the fundamental unit of development and survival.
   c. The appropriate unit for moral concern is the fundamental unit of development and survival.
   d. The ethical unit for moral concern is the fundamental unit of development and survival.
7. ________ ecologists advocate the development of a new eco-philosophy or ecosophy to replace the destructive philosophy of modern industrial society
   a. Social
   b. Deep
   c. Ethical
   d. Environmental

8. Which of the following statement is false?
   a. The Gaia theory states that the biosphere of this planet has most or all of the essential characteristics of a living organism.
   b. Gaia model represents the planet as a super organism.
   c. Earth does not belong to us, rather we belong to it.
   d. Earth is really the unrelated survival unit.

9. Which of the following shares with deep ecology the view that the foundations of environmental crisis lie in the dominant ideology of modern western society?
   a. Deep ecology
   b. Social ecology
   c. Radical ecology
   d. Social change

10. ________ ethics deals with the moral questions that arise from globalisation.
    a. Global
    b. Universal
    c. Environmental
    d. Deep
Case Study I

The Satyam Fiasco

“It was like riding a tiger, not knowing how to get off without being eaten ... I am now prepared to subject myself to the laws of the land and face the consequences thereof.”, Ramalinga Raju, Satyam Founder and Chairman

Case Overview

In January 2009, Byrraju Ramalinga Raju, the Chairman and Founder of Satyam, resigned after confessing to having orchestrated an accounting fraud since 2001. He admitted to manipulating the firm’s accounts to report profits that were more than 10 times the actual figures and reported a cash balance of US$1.5 billion that was non-existent. This case describes the nature of the fraud, the role of different parties involved and the aftermath of the scandal. The objective of this case is to allow a discussion of issues, such as business practices and the corporate governance environment in India, accounting fraud, board composition, director compensation, and the role of independent directors and auditors.

Satyam and Its Founder

In 2009, Satyam, translated as ‘Truth’ in Sanskrit, was considered among the pioneers of the information technology (IT) sector in India, with revenues of over US$2 billion. It was the only Indian company to be listed on three international stock exchanges and had even received the greatly-admired Golden Peacock Award for its achievements in corporate governance. It competed with the largest global technology firms such as Infosys and Wipro.

Satyam was founded by Ramalinga Raju, one of the most respected Indian business leaders. He belongs to a family that owned vast tracts of land and land continued to be his passion even after the global success of Satyam. He also maintained a spotless public image. A reporter who covered Satyam said of his impression of Raju, “It’s difficult to find a more soft-spoken Indian CEO ... he opens up only when you ask him about corporate governance issues”. Due to such an image, he was promoted as the icon of Hyderabad, the IT hub of India, by its Chief Minister at the time.

However, Raju’s public image was in sharp contrast to several controversies that had dogged his career. He was investigated for swindling funds from the public offering of Satyam on NYSE and Satyam Infoway on NASDAQ. He was also convicted in a tax evasion case. In addition, in 2008, the World Bank blacklisted Satyam for providing ‘improper benefits’ to its staff. His shares in Satyam were pledged to financial institutions to raise funds to buy land at prices higher than the market price, creating an effect similar to that of rigging prices. Yet, despite these, he received various prestigious awards including the Ernst & Young Entrepreneur of the Year in 2007.

The Board of Directors

Satyam’s board of directors was responsible for overseeing strategy, approving major corporate initiatives and reviewing performance. A Wharton professor, Saikat Chaudhuri, notes that in Indian firms such as Satyam, the board is involved only at the strategic-level while it is the founder who runs the show.

There were three board committees, the Audit, Remuneration and Investors’ Grievance Committees. Contrary to the prevailing best practices, there was no Nominating Committee. Other than Raju, Satyam had two other executive directors - his brother, B. Rama Raju, and Ram Mynampati. Contrary to the prevailing best practices, there was no Nominating Committee. Other than Raju, Satyam had two other executive directors, his brother, B. Rama Raju, and Ram Mynampati.

Of the six non-executive directors on the board, five were considered independent. An independent director, according to rules issued by the Securities and Exchange Board of India (SEBI), is required to be a person who has no material pecuniary relationship or transactions with the company, its promoters, its management or subsidiaries. One of the non-executive directors, Krishna Palepu, a professor of accounting and specialist in corporate governance at Harvard, worked as a consultant for Satyam and thus was not considered an independent director.
Among the five independent directors, Srinivasan was the longest serving, having been on the board since 1991. He, together with Rao and V. S Raju, sat on both the Audit and Remuneration Committees. In addition, Rao was the Dean of the Indian School of Business (ISB) where Raju was a board member. The ISB had received a generous grant of Rs35 crore (US$6.6 million) from Srini Raju, the brother-in-law of Ramalinga Raju and Chief Technical Officer at Satyam, for research done by its Centre for IT & Networked Economy (CITNE). Interestingly, according to the disclosure of directors’ remuneration for 2008, Rao was paid a basic fee called ‘commission’ of Rs100,000 (or about US$1,800), while the other non-executive directors were paid basic fees ranging from Rs1,133,333 (about US$21,200) to Rs1,200,000 (about US$22,500).

The non-executive directors also received small meeting fees called ‘sitting fees’. Krishna Palepu was paid Rs9.1 million (US$173,500) and 10,000 shares (equivalent to 5,000 ADR) of which Rs7.9 million (US$150,000) was professional fees for consulting services he provided. All other directors received compensation in the range of Rs1.2-1.3 million (US$22500-24500) in addition to at least 5,000 shares of share-based compensation in the form of restricted stock units.

Being highly respected in the industry, Satyam’s directors were in high demand to sit on well-known listed companies. Vinod K Dham (Dham) was the Vice President and General Manager of Intel and sat on a total of eight boards. The former cabinet secretary to the Government of India and a member of the 12th Finance Commission, T. R. Prasad (Prasad), also sat on eight boards of local listed companies.

**Business Culture in India**

With deep roots in the structure of social hierarchy derived from influences of Hinduism, the workplace was characterised by junior employees obeying orders from their seniors. Discussions and decisions were initiated by the senior most executives. For junior employees to say ‘no’ could be perceived as being impolite and offensive to those in authority.

**From India’s Crown Jewel to Biggest Fraud**

Ramalinga Raju had been manipulating Satyam’s books since 2001 to report results that would compare favourably with those of Infosys and Wipro. This was to maintain the firm’s corporate image as being among India’s IT pioneers. In addition, higher corporate profits would result in higher share prices, helping Raju obtain more funds to purchase land.

Raju had hoped to cover the fictitious assets he showed on Satyam’s books with real cash from Maytas Infra and Maytas Properties, companies owned by his sons, by merging the two firms with Satyam. On 16 December 2008, he convened a board meeting to seek approval for this transaction with a combined value of US$1.6 billion. As he and his brother Rama were interested parties, they were absent from the meeting. The non-executive and independent directors present, voiced strong concerns against the proposal, “You can’t treat us as a mere rubber stamp and expect us to say ‘yes’ to whatever you decide. What is the use of having directors like us, when you are not going to consult us at all?” – Srinivasan

“Will this move result in diluting the core competency of the company? What are the risks involved?” – Rao

However, the senior managers of Maytas making the presentation were duly briefed by Raju on how to successfully gain in-principle approval from the board.

**The Satyam Fiasco**

After the approval was received, Raju made an announcement on NYSE regarding the company’s plans to merge with Maytas. Investors disapproved strongly, believing that the transaction was intended to benefit the Raju family.

The house of cards began to collapse from this point on. Amidst the chaotic situation, Satyam lost public trust, its share price tumbled and the Maytas deal was abandoned. The World Bank soon announced that it had blacklisted Satyam for providing ‘improper benefits’ to its staff. In addition, three of its directors, Srinivasan, Dham and Palepu, resigned from the board after the announcement of the merger, making stern statements which questioned the promoters’ actions.
“I (Srinivasan) am left with no option but to resign with immediate effect. I had raised many issues related to procedures and had expressed reservations during the board meeting. I had not cast a dissenting vote against the deal for which I take moral responsibility.”

Interestingly, Palepu dramatically changed his stance regarding the reason for his resignation. Originally he attributed his resignation to not being able to fulfil all his duties at Satyam due to his teaching commitments at Harvard. However, he later said that his resignation was prompted by the revelation that Ramalinga Raju and other promoters had pledged their shares in Satyam to financial institutions, which were later sold due to margin call pressures.

With few options remaining, Raju engaged Merrill Lynch to seek strategic options for the future of Satyam. Merrill Lynch found material irregularities in Satyam’s accounts. On realising that his fraud had come to light, Raju resigned from his position and confessed to inflating profits, reporting a US$1.5 billion cash balance that was non-existent, overstating interest income and understating liabilities.

**Satyam’s Compartmentalised Structure—Key to the Fraud**

Crucial to the successful commission of the fraud was that Raju had compartmentalised the structure of Satyam such that among its reported 51,000 employees, only a handful would really know what was going on within the firm. Each department had its own Finance unit which would report to a central Finance team headed by the CFO, Srinivasa Vadlamani. Each unit was unaware of the performance of other departments. Raju handpicked the top management which consisted of a few professionals and his family members. In addition, they were allotted large quantities of Satyam shares to ensure that they had incentives to take actions that would help boost the stock price.

Satyam had a whistleblower policy supervised by the Audit Committee. Under this policy, an employee had written to Krishna Palepu stating that the books of the firm had been manipulated. Although this letter was circulated among the board, no action was taken.

**Cleaning up the Mess**

On the day the scandal became public, Satyam’s stock price fell from Rs179.1 (US$3.40) to Rs23.85 (US$0.45), an 87 per cent fall in value in one day. On 10 January, the Company Law Board decided to bar the existing Satyam board from operating and appointed 10 nominee directors. The swift action was taken due to the significance of both Satyam and the IT sector to India’s economy and image abroad. The regulator for Chartered Accountants in India issued a show-cause notice to Satyam’s auditor PricewaterhouseCoopers (PwC) for its complicity in the fraud as it had certified Satyam’s accounts as being true and fair. Ramalinga Raju was arrested and charged with several counts, including forgery, breach of trust and criminal conspiracy. During the trial, it was revealed that although Satyam claimed to have 51,000 employees, the actual number was 40,000. It was alleged that Raju was withdrawing a sum of Rs20 Crore (US$4 million) each month to pay these non-existent employees.

After the scandal, the Golden Peacock award for best corporate governance was stripped from Satyam. After a public auction in 2009, Satyam was taken over by Tech Mahindra, the technological arm of the conglomerate Mahindra & Mahindra.

**Regulatory Reforms and Impact on Independent Directors**

The case raised a multitude of questions on the role of independent directors on the boards of even the highest echelon of Indian companies. Professor Jitendra Singh, a management professor at Wharton, notes that on some Indian boards, there exists an attitude that board members work for those who brought them on to the board. This could have been the problem with the Satyam board itself.

In reaction to the scandal, the Indian government introduced the Companies Bill 2009 to address corporate governance, among other issues. The Bill added several criteria to the appointment requirements for an independent director. These include not being an employee of the firm for three preceding years from appointment; an employee of an auditing, legal or consulting firm associated with the company; holding more than 2 per cent of the voting power of the company; or being a member of an organisation receiving more than 25 per cent of its income from the company.
Rajesh Chakrabarti, professor at the Indian School of Business, wrote an article in the Economic Times highlighting the shortage of independent directors in Indian boardrooms after the scandal. In the month following the scandal, resignations by independent directors rose to 109 from the average of 30. Over a longer period, resignations increased by 20 per cent. He noted that the prevailing consensus among independent directors was that they were reassessing the risks of a board seat; a lifetime of reputation built could be tarnished by the actions of a single unscrupulous promoter like Ramalinga Raju. These changes, he asserts, do not bode well for the future of corporate governance in Indian enterprises.

Recent Developments
In November 2011, after spending almost 3 years in prison, Ramalinga Raju, Rama Raju and Srinivasa Vadlamani were granted bail. The reason cited by the court was that they had already served a large portion of their possible sentence since the maximum punishment for their offence was 7 years’ imprisonment. In addition, as the investigation of the case was nearing its end, it was felt that they could not influence the investigation in any manner. In January 2012, Satyam Computer Services, now owned by the Tech Mahindra group, filed a lawsuit against its former board of directors, certain former employees and PwC its statutory auditor, for ‘perpetrating fraud, breach of fiduciary responsibility, obligations and negligence in performance of duties’. This followed a penalty of US$17.5 million imposed jointly on Satyam, PwC and its other partners by the US Securities and Exchange Commission in April 2011 for fraudulently overstating the company’s accounts.


Questions

1. What is an independent director?
   Answer
   An independent director, according to rules issued by the Securities and Exchange Board of India (SEBI), is required to be a person who has no material pecuniary relationship or transactions with the company, its promoters, its management or subsidiaries.

2. What is the problem in the some Indian board?
   Answer
   Professor Jitendra Singh, a management professor at Wharton, notes that on some Indian boards, there exists an attitude that board members work for those who brought them on to the board. This could have been the problem with the Satyam board itself.

3. The Companies Bill added several criteria to the appointment requirements for an independent director. What are these criteria?
   Answer
   The Bill added several criteria to the appointment requirements for an independent director. These include not being an employee of the firm for three preceding years from appointment; an employee of an auditing, legal or consulting firm associated with the company; holding more than 2 per cent of the voting power of the company; or being a member of an organisation receiving more than 25 per cent of its income from the company.
Case Study II

Nokia case

Pursuant to the provisions of the Finnish Companies Act and our articles of association, the control and management of Nokia is divided among the shareholders in a general meeting, the Board of Directors and the Group Executive Board. Our Articles of Association provides for a Group Executive Board, which is responsible for the operative management of Nokia. The Chairman and the members of the Group Executive Board are elected by the Board of Directors. Only the Chairman of the Group Executive Board can be a member of both the Board of Directors and the Group Executive Board.

Board of Directors
The Board decides on matters that, in relation to the Group’s activities, are significant in nature. Such matters include confirmation of the strategic guidelines, approval of the periodic plans and decisions on major investments and divestments. The Board appoints the CEO, the President, the Chairman and the members of Nokia’s Group Executive Board. The Board also confirms the remuneration of the CEO and the President.

The roles and responsibilities of the Board and its committees are defined in the Corporate Governance Guidelines and the committee charters. The Board’s committees consist of the Audit Committee, the Personnel Committee and the Corporate Governance and Nomination Committee. The Board regularly reviews these guidelines and charters in order to ensure that they appropriately comply with what the Board believes to be best practices of corporate governance. The Board and each of its committees conduct annual performance self-evaluations.

Group Executive Board
Nokia’s articles of association provides for a Group Executive Board, which is responsible for managing the operations of Nokia. The Chairman and the members of the Group Executive Board are elected by the Board of Directors. Only the Chairman of the Group Executive Board can be a member of both the Board of Directors and the Group Executive Board.

Annual General Meeting
The shareholders of Nokia use their decision-making power in Nokia’s general meetings. The Annual General Meeting is usually held in each March, April or May.

Auditor
The auditor is elected annually by the Annual General Meeting. PricewaterhouseCoopers was elected as the auditor for 2006 in the Annual General Meeting held on March 30, 2006.

Corporate Governance Practices
Nokia follows rules and recommendations of the Helsinki, New York, Stockholm and Frankfurt stock exchanges, where applicable. Nokia’s corporate governance practices comply with the Corporate Governance Recommendation for Listed Companies approved by the Helsinki Exchanges in December 2003, effective as of July 1, 2004. The Recommendation recommends a company to describe the manner in which the internal audit function of the company is organised. As Nokia has comprehensive risk management and internal control processes in place, there is no separate internal audit function at Nokia.

Under the New York Stock Exchange’s corporate governance listing standards, listed foreign private issuers, like Nokia, must disclose any significant ways in which their corporate governance practices differ from those followed by US domestic companies under the NYSE listing standards. There are no significant differences in the corporate governance practices followed by Nokia as compared to those followed by US domestic companies under the NYSE listing standards, except that Nokia follows the requirements of Finnish law with respect to the internal audit function and the approval of equity compensation plans. Under Finnish law, stock option plans require shareholder approval at the time of their launch. All other plans that include the delivery of company stock in the form of newly issued shares or treasury shares require shareholder approval at the time of the delivery of the shares or, if shareholder approval is granted through an authorisation to the Board of Directors, not earlier than one year in advance of the delivery of the shares. The NYSE listing standards require that equity compensation plans be approved
Nokia comprises four business groups: Mobile Phones; Multimedia; Enterprise Solutions and Networks.

The Nokia’s strategy continues to focus on three activities to expand mobile communications in terms of volume and value:

- Expand mobile voice
- Drive consumer multimedia
- Bring extended mobility to enterprises

**Expand mobile voice**

Nokia can further develop the mobile voice market, both in markets where mobile telephony is just taking off as well as in more mature markets. Nokia estimates the number of mobile subscriptions to surpass three billion in 2008. Nokia’s position in mobile voice is strong thanks to their key assets and excellent logistics capabilities.

**Drive consumer multimedia**

Nokia is playing a key role in shaping this emerging complex market by focusing on the fastest growth areas, imaging, music, and games, to name a few.

**Bring extended mobility to enterprises**

Nokia will provide a range of competitive, specifically targeted handsets, platforms, and connectivity solutions so enterprises can boost productivity through the power of mobility.

On January 1, 2004, Nokia restructured into four business groups, Mobile Phones, Multimedia, Enterprise Solutions, and Networks - to better focus and capitalise on the opportunities in each of these areas. Throughout all these, the Networks business group provides the infrastructure backbone and enables end-to-end communications.

**Corporate Governance Practices**

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**Questions**

1. Who all are appointed by the board?
2. Where and when do the shareholders of Nokia use their decision making power?
3. What is Nokia’s corporate governance practices comply with?
Case Study III

Napster Copyright Infringement Case

Duplicating software for friends, co-workers or even for business has become a widespread practice. All software programs are protected by copyright laws and duplicating them is an offense. How, then, has making illegal copies become such a common and accepted practice in people’s homes and places of work?

Part of the answer revolves around the issue that software isn’t like some other intellectual property. Intellectual property is that which is developed by someone and is attributable directly to the thinking process. Software is different from a book in that anyone can easily copy it and an exact replication is achievable. Another reason is related to cultural differences. People don’t see copy as stealing. People don’t find anything wrong in making a video copy of a hit feature film and selling it or hiring out. People defend their behaviour by saying: ‘Everybody does it! I won’t get caught! Or no one really loses!’

The same issue of copyright is involved in the famous Napster case in America. Napster is an online service that allows computer users to share high-quality digital copies (MP3s) of music recordings via the internet. The San Mateo-based company doesn’t actually store the recordings on its own computers, but instead provides an index of all the songs available on the computers of members currently logged on to the service. Napster, therefore, functions as a sort of clearing house that members can log on to, search by artist or song title, and identify where songs of their interest are so and download them from another user’s hard drive.

Napster has become one of the most popular sites on the internet, claiming some 15 million users in little more than a year. Indeed, so many students were downloading songs from Napster, that many universities were forced to block the site from their systems in order to regain bandwidth. Napster’s service has been almost as controversial as it has been popular. Barely a year after its launch, it was sued by the Recording Industry Association of America (RIAA), which represents major recording companies such as Universal Music, BMG, Sony Music, Warner Music Group, and EMI. The RIAA claimed by allowing users to swap music recordings for free, Napster’s service violated copyright laws. It also sought an injunction to stop the downloading of copyrighted songs owned by its members as well as damages for lost revenue. It argued that song swapping via Napster and similar firms has cost the music industry more than $300 million in lost sales. A few months after the RIAA lawsuit was filed, Metallica, a heavy metal band, and rap star Dr. Dre filed separate lawsuits accusing Napster of copyright infringement and racketeering. Lars Ulrich, Metallica’s drummer, told a senate committee that Napster users are basically stealing from the band every time they download one of its songs.

The 1998 Digital Millennium Copyright Act (DMCA) grants immunity to Internet Service Providers for the actions of their customers. Napster attorneys argued that the company has broad protection from copyright claims because it functions like a search engine rather than having direct involvement with music swapping. However, according to the legal community, ‘Napster does not take the legal steps required of search engines in dealing with copyright violations.’

Despite its claim, Napster was found guilty of direct infringement of the RIAA’s musical recordings. To date, the service has not been shut down, because doing so could violate the rights of artists who have given Napster permission to trade their music. However, the company was required to block all songs on a list of 5,000 provided by the RIAA.

Questions
1. Do you believe that there is nothing wrong in copying software, music or a video film?
2. Based on the facts of the Napster case, who do you think should have control over intellectual property- the artists or distributors of their work? How did the legal system answer this question?
3. Copying of software, music and films is very common in India. Is it due to our socioeconomic factors? Discuss.
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Recommended Reading

Self Assessment Answers

Chapter I
1. a
2. b
3. c
4. b
5. d
6. b
7. c
8. b
9. a
10. d

Chapter II
1. a
2. b
3. c
4. c
5. d
6. b
7. d
8. b
9. a
10. d

Chapter III
1. b
2. a
3. b
4. c
5. a
6. b
7. d
8. b
9. d
10. c

Chapter IV
1. a
2. b
3. d
4. c
5. d
6. a
7. d
8. a
9. b
10. d
Chapter V
1. b
2. a
3. b
4. c
5. d
6. d
7. a
8. c
9. a
10. c

Chapter VI
1. c
2. a
3. c
4. a
5. d
6. c
7. d
8. b
9. b
10. b

Chapter VII
1. c
2. b
3. c
4. a
5. b
6. d
7. a
8. d
9. a
10. b

Chapter VIII
1. b
2. c
3. a
4. b
5. d
6. c
7. b
8. d
9. b
10. a