Corporate Governance, Social Responsibility and Business Ethics

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Abstract
Corporate governance has shifted from its focus on agency conflicts to address issues of ethics, accountability, transparency, and disclosure. Moreover, Corporate Social Responsibility (CSR) has increasingly focused on corporate governance as a vehicle for incorporating social and environmental concerns into the business decision-making process, benefiting not only financial investors but also employees, consumers, and communities. Currently, corporate governance is being linked more and more with business practices and public policies that are stakeholder-friendly.

This study concurs with research findings from the extant literature that good practice in corporate governance, social responsibility and business ethics. This article examines these developments and their impact on the formulation of a hybridized body of business legal norms by proceeding in three stages: First, the article explores the recent transformations in the regulation of corporate governance, corporate social responsibility and ethics. Second, it reads these transformations as a convergence that encompasses both corporate self-regulation and the efforts by various social groups to make it more effective. Third, the article discusses the prospects and challenges of this convergence by outlining a series of conceptual and methodological inquiries as well as policy ramifications to be pursued by scholars and practitioners in the field of law and corporate conduct.

Introduction
Corporate social responsibility (CSR) and business ethics represent one of the most progressive developments in the private sector, urging private companies to evaluate their operations differently from what they are accustomed to and to stretch the borders of their responsibilities. Narrow shareholder value approach is no longer valid under current environmental and social challenges and a more open stakeholder model is paving the way into the business world as a tool for creating more innovative, competitive and sustainable business that benefits both business and society.

As CSR principles are increasingly becoming integrated into business operations of companies from the EU, businesses will be required to demonstrate their commitments to social and environmental values. Also, as investment foundations start to evaluate investment projects taking into account social and environmental criteria and with the increasing emergence of socially responsible investment funds, there is a strong need for companies to comply with these new criteria and take advantage of the pool of these funds. Although the concept of corporate social responsibility is based predominately on experiences of developed countries the context in FYR Macedonia and other developing countries differs greatly. While CSR is based on a set of universal principles, their interpretations as well as related societal expectations vary according to geography, culture and level of development. Thus, one has to take into account the local specifics, especially the lack of an established model of corporate governance, lack of local socially responsible investment and investment funds, and the weak enforcement capacity of the Government. A healthy board process creates dynamics in which everyone is engaged and listening, adding value, supportive of open and authentic exploration of ideas and participating in balanced ways. Strongly divergent views can be aired and melded into a single, well-supported position and off-purpose behavior is handled constructively. All meeting procedures are designed to create this climate and to stay on track. Additionally, the board must attend to the processes it uses to monitor its overall effectiveness and development.

Main aims of the Study

The research was carried out in February-May 2010 among all relevant stakeholders in India: local and foreign businesses, business and professional associations, trade unions, local and national governments, non-governmental organizations, media and academia. The main aims of this baseline study were to:

• Identify the actors who promote CSR at country level.

• Assess the level of engagement in CSR of actors promoting CSR at country level through mapping their recent past and present CSR promotion activities.

• Assess the level of dialogue between different actors promoting CSR.

• Identify the level of business engagement in CSR implementation at India level and collect examples of good practices.

• Identify capacity gaps/constraints of CSR promoters and business entities in engaging in CSR activities.

• Formulate recommendations and suggest specific activities based on the findings of the survey.

Methodological approach of the Study

This study relies on a survey we conducted in 2009 and 2010 of 20 Indian companies. I received 11 responses, for an overall response rate of 55%. The survey was conducted with support from S. D. (P.G.) College, Sri Ganganagar (Rajasthan), one of India's top business schools, which provided a cover letter urging companies to respond. We mailed a written survey to each firm, followed up with additional mailings and phone calls, and arranged site visits to each company. We promised confidentiality to all respondents, and thus do not name individual companies in this research. I surveyed companies with offices in one of India's largest cities –Mumbai, New Delhi, Noida and others. I approached essentially all companies offices in these cities. The response rates were higher.. Thus, it was important to ensure that the survey was completed by a knowledgeable person. Of the 11 respondents, 10 were the company secretary or chief legal officer, 1 was the senior official in the finance department.

The interview data resulted in a number of issues being developed. These issues included: role of the board, social responsibility; business ethics; clause 49; rules of Indian Govt and SEBI; and company performance.

Social Accounting and Reporting

Taking responsibility for its impact on society means in the first instance that a company accounts for its actions. Social accounting, a concept describing the communication of social and environmental effects of a company's economic actions to particular interest groups within society and to society at large, is thus an important element of CSR.

A number of reporting guidelines or standards have been developed to serve as frameworks for social accounting, auditing and reporting. In some nations legal requirements for social accounting, auditing and reporting exist (e.g. in the French bilan social), though agreement on meaningful measurements of social and environmental performance is difficult. Many companies now produce externally audited annual reports that cover Sustainable Development and CSR issues ("Triple Bottom Line Reports"), but the reports vary widely in format, style, and evaluation methodology (even within the same industry). Critics dismiss these reports as lip service, citing examples such as Enron's yearly "Corporate Responsibility Annual Report" and tobacco corporations' social reports.

Potential Business Benefits

The scale and nature of the benefits of CSR for an organization can vary depending on the nature of the enterprise, and are difficult to quantify, though there is a large body of literature exhorting business to adopt measures beyond financial ones (e.g., Deming's Fourteen Points, balanced scorecards). Orlitzky, Schmidt, and Ryne found a correlation between social/environmental performance and financial performance. However, businesses may not be looking at short-run financial returns when developing their CSR strategy. The definition of CSR used within an organization can vary from the strict "stakeholder impacts" definition used by many CSR advocates and will often include charitable efforts and volunteering. CSR may be based within the human resources, business development or public relations departments of an organisation or may be given a separate unit reporting to the CEO or in some cases directly to the board. Some companies may implement CSR-type values without a clearly defined team or programme. The business case for CSR within a company will likely rest on one or more of these arguments.

Ethical Consumerism

The rise in popularity of ethical consumerism over the last two decades can be linked to the rise of CSR. As global population increases, so does the pressure on limited natural resources required to meet rising consumer demand (Grace and Cohen 2005, 147). Industrialization in many developing countries is booming as a result of technology and globalization. Consumers are becoming more aware of the environmental and social implications of their day-to-day consumer decisions and are beginning to make purchasing decisions related to their environmental and ethical concerns. However, this practice is far from consistent or universal.

Globalization and Market Forces

As corporations pursue growth through globalization, they have encountered new challenges that impose limits to their growth and potential profits. Government regulations, tariffs, environmental restrictions and varying standards of what constitutes labour exploitation are problems that can cost organizations millions of dollars. Some view ethical issues as simply a costly hindrance. Some companies use CSR methodologies as a strategic tactic to gain public support for their presence in global markets, helping them sustain a competitive advantage by using their social contributions to provide a subconscious level of advertising.(Fry, Keim, Mieners 1986, 105) Global competition places particular pressure on multinational corporations to examine not only their own labour practices, but those of their entire supply chain, from a CSR perspective.

Social awareness and Education

The role among corporate stakeholders to work collectively to pressure corporations is changing. Shareholders and investors themselves, through socially responsible investing are exerting pressure on corporations to behave responsibly. Non-governmental organizations are also taking an increasing role, leveraging the power of the media and the Internet to increase their scrutiny and collective activism around corporate behavior. Through education and dialogue, the development of community in holding businesses responsible for their actions is growing.

Requirements for effective Boards….beyond fine tuning

As CEO, you're accountable for results whether your board helps or hinders you in working toward them. Ensuring that key requirements are met, requirements that affect how well equipped board members are to work together, will provide a sound foundation from which the strategic leadership and fulfillment of role and responsibilities will more likely occur. These requirements go beyond fine tuning…they are essential.

This article is the fourth in a series intended to help the CEO think through the issues involved in developing a board to contribute meaningfully to the purpose, vision, strategy and development of the organization. The first article, Your Board: Dynamic, Difficult or Detrimental, dealt with how boards affect the optimization of performance through strategic leadership. The second article in the series, Your Board: Proactive Partnering or Reactive Interference? addressed the role or fit of the board with the organization as a whole. The third article, Your Board's Approach to Its Responsibilities: Resting on Laurels or Raising the Bar, discussed the responsibilities appropriate to the board's role.

If you want to see a CEO's passion go from 0 to 60 in 6 seconds flat, you might talk about the organization's vision, or you might talk about the experience he or she has had working with a board lacking the basic requirements for effectiveness… such as working without the competencies needed, low commitment among directors, or about a board whose processes for working together undermine any hope for productive outcomes.

CEOs with these experiences could become missionaries about how to prevent problems before they develop. They can tell you about the board that grew to 33 members as a result of acquisitions. You need to speak from a pulpit to get the message heard at the end of a table that long! In this informal and extraverted group, there isn't enough air space available for input from everyone within a reasonable board meeting time frame…not a good return on the investment in director compensation. What's even worse, too many of these directors are perceived to hold the organization back while there is no term limit policy; or there is a policy and it isn't used. There is a norm that once elected to the board, you just about have to do something criminal to lose the seat.

Other CEOs can describe the effects of having directors who lacked the competencies and commitment to fill their roles. One CEO we know created the board with 45% of its membership coming from the same industry as the organization. It is no surprise when their strategic perspective endorses a "me too" path for the organization. Another CEO selects directors who can help sell the organization, using seats on the board in return for revenue generation, but too often those directors have not brought the general management perspective, visionary capacity and financial literacy needed. Finally, there is the CEO whose "blue chip" directors are stretched by maintaining four or more directorships when they are still fully engaged in their own businesses. Their full calendars and sporadic contributions to pre-work in committees create untenable delays for the board.

Attention to five key requirements for effective and efficient boards can make all the difference: the information furnished to directors, the independence with which directors can operate, the commitment of directors to the organization's needs, processes used in conducting the board's work, and the competencies of the board and each of the directors.

Information makes differences

One CEO and board with whom we worked faced the difficult decision of whether to relocate their corporate headquarters to a different location. Several board members with ties to the community in which the organization was founded vigorously opposed the move. Continuing to remain in the same location was adversely affecting attracting and retaining key talent and was limiting access to growth markets, both of which were threatening the organization's ability to thrive and survive. When the CEO put together a compelling package of information for the board, prior to a retreat to discuss a possible move, he was able to show substantiation from numbers of outside experts that proceeding with plans to move the headquarters was the best decision for the organization. That package, including the letters of testimony from people he had consulted, made the difference in a very emotionally charged situation. Even with the comprehensive information, the board needed a carefully designed process for working together in order to use the information objectively.

Savvy directors, with busy schedules, require high quality, concise, pertinent and timely information in order to be prepared to make the most of all-too-limited board meeting time. When we administer surveys of board effectiveness, few organizations are credited with disseminating the information in a concise and timely manner. The burden of gathering and presenting the information in a "director-friendly" fashion resides with the organization.

The information that is needed includes the status of the competition, key strategic trends, possible mergers and acquisitions, and the status of the implementation of plans. Sources should be varied, including investors, market analysts, customers, employees, and outside experts.

Independence simplifies maintaining clear bound areas

Given the difference between the roles of the board and that of management, it is academically easy to advocate for considering a nonexecutive chairman who is not a present or former employee of the organization. The reality, however, is that according to the Korn Ferry 1999 Board of Directors Study, only nine percent of the companies participating have a nonexecutive chairman who is not a present or former employee. And since this proportion is unlikely to change significantly within the next few years, the challenge is creating working processes that optimize the contributions of both management and directors.

If the key role of the board is to challenge the assumptions of senior management's strategic thinking, for the purpose of ensuring the organization's long-term viability, then the board needs a structure that allows that to happen, even if the chairman and CEO are the same. One option is to limit the number of inside directors (the average number of inside directors on corporate boards today is two), elect a lead director among the outside directors and provide for outside directors to meet in executive session without the CEO present. Only about 30% of current corporate boards follow these last two practices; however, they are considered to be among the Best Practices of boards of high performing organizations. Additional practices to ensure independence can prevent allegations of conflict of interest and other problems.

Commitment results from having a stake

Most CEOs that we have worked with feel very strongly that directors should share an ownership stake, with many "best boards" requiring a $100K investment as a benchmark. Certainly not all boards can set the bar there, but it is worth scaling appropriately. Investing physical, intellectual and emotional energy flows more naturally from a fiscal investment.

The energy investment is considerable, beyond the attendance at a minimum of 75% of meetings, and participation in committee work and strategic retreats. Those directors, who are thinking about the organization strategically and globally, invest their own time following and investigating trends both inside and outside the industry. They want resources beyond the information fed to them by the organization as a way of providing independent input and challenging assumptions.

Most of all, commitment to the best interests of the organization is required. The director's identity is with the shareholders…all shareholders. We've seen too many boards with factions, each representing a subset of constituents, with directors positioned around the table by "camps". The effective director is a strong individual, representing all shareholders (without personal interest frontiers prevailing), committed to change as needed, to being challenged by other strong individuals and to facing the ambiguity of the future, all for the greater good.

Sound processes strengthen board dynamics

It is clearly the responsibility of the chairman to establish process integrity within the board, and that goes much beyond Robert's Rules. For example, how can directors fulfill their role of asking "what if" and challenging the thinking when there is no time for discussion, no norm for director participation beyond a "rubber stamp" vote of committee pre-work and there are 27 directors around the table? Boards who limit membership to 10 to 15 directors and who examine recommendations from committees then make decisions as a whole are in a better position to assume their responsibilities and liabilities as directors.

A healthy board process creates dynamics in which everyone is engaged and listening, adding value, supportive of open and authentic exploration of ideas and participating in balanced ways. Strongly divergent views can be aired and melded into a single, well-supported position and off-purpose behavior is handled constructively. All meeting procedures are designed to create this climate and to stay on track.

Additionally, the board must attend to the processes it uses to monitor its overall effectiveness and development. These processes will be the subjects of the fifth and final article in the series.

Role of the Board

Among the many shortcomings of the Satyam episode has been the role of independent directors who were supposed to safeguard the interests of all stakeholders. While the three committees (See: Corporate Governance Committees) have explicitly mentioned the role, independence, remuneration and responsibilities of independent directors, the same has not translated into becoming an adequate check on managerial excesses. Says Andrew Holland, CEO, equities, Ambit Capital, "Independent directors should also (in addition to the management) be held accountable for board decisions and audit-related compliance practices." While there have been suggestions for a selection committee to choose independent directors, mandatory training, performance assessments, limit on directorships and compulsory attendance of Board meetings, two key areas relating to CEO/Board chair segregation and number of independent directors could be the right steps forward.

Says Neville Dumasia, head, Governance, Risk and Compliance, KPMG, "The concept of CEO and Board chair separation is well accepted in Europe, and American companies are steadily moving in that direction. This would bring a better balance in the boardroom.

"The second issue of a majority of independent directors (number currently varies from a third to a half), which is the case with companies in NYSE and Nasdaq, could prove tricky as Indian boards are promoter-dominated. Regulations could however, change all that. "In fact, in a number of European and American companies the only sitting executive on the Board is the CEO," says Dumasia.

Minority Shareholders

It can be believed that it is the institutional investors who have the tools, bandwidth and clout to extract information and play an activist role (as had happened in Satyam's case) in ensuring that managements don't go off-track. If institutional investors act collectively, they can demand the required changes at companies they have invested in. Says Anup Bagchi, executive director, ICICI Securities, "While independent directors can certainly play an important role in ensuring better risk management, demand for good governance by institutional shareholders is the best driver towards higher governance standards." Establishing minority shareholders' groups can also be a positive step. Individual shareholders through these groups can communicate with institutional shareholders for taking up their concerns with the company's management.

While retail investors cannot bring about many changes to a corporate agenda, they can take precautions before making investments. Says Shailesh Haribhakti, executive chairman and managing partner, Haribhakti & Co, "The criteria of consistent track record, transparency in dealings with stakeholders, disclosure of all relevant information and accountability at levels of the organisation should help in making the investment decision." While it might be difficult for retail investors to get hold of information on all aspects of the organisation they will be well served to keep an eye out for notes to the accounts. Says Holland, "Notes to the accounts are a useful source of information and reading them gives an idea of the exceptions or practices that the auditor has chosen to single out."

While our survey shows that experts believe that retail investors are indifferent about corporate governance, the Satyam episode will probably highlight the need to weigh this aspect. A KPMG study on companies listed in the UK and US indicated that markets tend to give a lower valuation to companies with perceived corporate governance problems.

In India companies such as HDFC and BHEL tend to get a better valuation than their peers as do professionally-run companies like HUL, ITC and Infosys not just due to their performance, but also due to their adherence to corporate governance norms.

Conclusions

In my study I also found leading companies like Infosys, HDFC, Hindustan Lever, Wipro and ICICI scoring high in corporate governance. On the other hand, companies like Reliance Industries, Bajaj Auto, Mahindra and Mahindra, Grasim, Zee Telefilms, SBI and MTNL have been rated rather poorly.

Findings of study covered companies used in the composition of CNX S&P Nifty index. The researcher interviewed experts from different segments who were asked to rate these companies on a scale of 5 to 1 with regard to eight parameters.

These parameters were:

- The company efforts to maintain social responsibility and business ethics.
- The management's compliance with the norms of good corporate governance.
- The company's efforts to promote employee development.
- If the price charged by the company is affordable.
- Whether the company recognizes rights and fulfils obligations towards other stakeholders.
- Whether the company is sensitive to environment and doing enough to improve the quality of life of the society and satisfy public expectations of fairness and ethical conduct.

Infosys scored high on all the aspects and has been voted as the best in corporate governance. Reliance has done better in terms of shareholders perception, but not done much in other aspects. Companies like Zee Tele, MTNL, Mahindra and Mahindra, Bajaj Auto, SBI and Grasim have failed to find place among the top 10 companies in any of the eight parameters.

According to the study, there is enough evidence in Europe and the US that shows that good corporate governance invariably leads to good corporate performance and expects Indian companies to do the same. It says: Good corporate governance seeks to achieve a balance between business and ethics, which means the process of achieving the business goals has to be ethical and fair on all fronts.

Future Prospects

The issues of governance, social responsibility, business ethics, accountability and transparency in the affairs of the company, as well as about the rights of shareholders and role of Board of Directors have never been so prominent as it is today. The corporate governance has come to assume a centre stage in the Board room discussions.

India has become one of the fastest emerging nations to have aligned itself with the international trends in Corporate Governance. As a result, Indian companies have increasingly been able to access to newer and larger markets around the world; as well as able to acquire more businesses. The response of the Government and regulators has also been admirably quick to meet the challenges of corporate delinquency. But, as the global environment changing continuously, there is a greater need of adopting and sustaining good corporate governance practices for value creation and building corporations of the future.

It is true that the 'corporate governance' has no unique structure or design and is largely considered ambiguous. There is still lack of awareness about its various issues, like, social responsibility, business ethics, quality and frequency of financial and managerial disclosure, compliance with the code of best practice, roles and responsibilities of Board of Directories, shareholders rights, etc. There have been many instances of failure and scams in the corporate sector, like collusion between companies and their accounting firms, presence of weak or ineffective internal audits, lack of required skills by managers, lack of proper disclosures, non-compliance with standards, etc. As a result, both management and auditors have come under greater scrutiny.

But, with the integration of Indian economy with global markets, industrialists and corporates in the country are being increasingly asked to adopt better and transparent corporate practices. The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. If companies are to reap the full benefits of the global capital market, capture efficiency gains, benefit by economies of scale and attract long term capital, adoption of corporate governance standards must be credible, consistent, coherent and inspiring. Corporate should follow business ethics after considering their social responsibility alongwith earning profit.

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