This is the third part of a four part series of papers on business sustainability and ethics. The four parts are as follows:

- Part 1 – Understanding Sustainability
- Part 2 – Components of Sustainability
- Part 3 – Corporate Governance and Sustainability
- Part 4 – Role of Ethics in Sustainability

Introduction

In this paper the concept of corporate governance is discussed in order to gain a better appreciation thereof and to highlight the role of ethics in governance.

Corporate governance

From the King III Report (IoD, 2009b), corporate governance is essentially about effective, responsible leadership and responsible leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency. The King III Code provides a framework for corporate governance for South Africa, based on international best practice (IoD, 2009a).

Bandsuch, Pate and Thies (2008) describe corporate governance as a variety of principles and practices that direct the core processes of a business and state that corporate governance specifically “reflects the formalised values and procedures implemented by the business’ leadership in its various operations and interactions with stakeholders”.

Archer (2008) maintains that corporate ethics and standards of conduct are matters of governance and the organisation’s ethics officer should periodically update the board of directors on the health of the ethics programme, the results of significant investigations and any trends in company conduct that might be emerging. According to Johnson (2005), corporate governance practices are built on the premise that the leaders of companies have an obligation to be fair, transparent, accountable and responsible in their dealings with stakeholders and the public.
Rosouw (2008) normatively defines corporate governance as “the external and internal system by which corporations are controlled in order to ensure a balance between individual, corporate and societal interests”. He found on the theoretical level that shareholder models of corporate governance do not support the normative definition because they only consider the interests of shareholders, whereas stakeholder models of corporate governance are more likely to support the definition. He analysed six regional reports on the relationship between business ethics and corporate governance to test this definition against corporate governance practices in the different regions. It was found that the countries included in this survey were evenly split as to shareholder and stakeholder-orientations and that the normative definition of corporate governance only applied in those countries that subscribe to a stakeholder orientation to corporate governance.

In a study of the relationship between corporate governance compliance and corporate performance, Van der Bauwhede (2009) concludes that greater compliance with international best practices concerning board structure and functioning is significantly and positively correlated with the one-year-ahead return on assets (ROA).

Governance Approaches

Governance of corporations can be achieved through legislation, through the adherence to a voluntary code of principles and practices or through a combination of the two (IoD, 2009b). The United States of America has chosen the legislated option with legal sanctions for non-compliance. The countries of the Commonwealth and the European Union countries have opted for a combination approach, with an emphasis on the voluntary code of principles and practices. In South Africa, the approach proposed by the King III Report (IoD, 2009b) is “apply or explain”, where principles over-ride specific recommended practices. A board of directors could decide to apply a recommendation differently, or follow an alternative practice and still achieve the governance objectives of fairness, accountability, responsibility and transparency. Therefore, explaining why a different set of rules or practices was followed for specific issues, results in compliance. Compliance with governance issues that are legislated is considered essential (IoD, 2009b).

In America, despite the many existing rules, prosecutions and settlements, the response to the corporate scandals of the early 21st century has been primarily rule-based (Michael, 2006). The United States Congress passed the Sarbannes-Oxley Act of 2002 (USA, 2002) and the Securities and Exchange Commission and other agencies have promulgated numerous regulations implementing Sarbannes-Oxley and addressing corporate governance issues. Michael (2006) states that this post-scam preoccupation with rules and regulations could have been predicted: rules have become substitutes for the ‘right’ thing when the distinction between obeying the rule and acting ethically becomes blurred and thus ‘if something is legal, it’s ethical’. Michael (2006) concludes that rules, statutes and regulations have triumphed over ethics when they become the ceiling rather than the floor for desired ethical conduct. Michaelson (2006) agrees and argues that greater compliance only creates the illusion of ethical progress; “neither goodness without choice nor choice without goodness constitutes ethical progress”.

Section 404 of the Sarbannes-Oxley Act of 2002 (USA, 2002) imposes severe penalties on managers who falsely certify that they have reviewed and found adequate their company’s internal controls over financial reporting. However, Section 404 tests for failure of the reporting system and not for failure of the people involved in the review process, leaving good systems open to failure due to collusion (Kermis & Kermis, 2009). Kermis and Kermis (2009) also maintain that the Sarbannes-Oxley Act and several other privacy protection laws have not stopped corporate misconduct.

According to Donaldson (2007), the Sarbannes-Oxley Act and Sarbannes-Oxley style initiatives are frequently perceived by corporate leaders as an overly-expensive misuse of public power. The government is viewed by most business leaders in a market economy as having a legitimate role to play in regulating business activities – but only up to a point. Donaldson (2007) believes that the perception of
abusive behaviour by government may result in “ethical-blowback”, or attempts to elude government regulation. Murphy (2008) is of the opinion that law can never be enough on its own to make business ethical. Dorr (2008) posits that fear of punishment is an inadequate incentive for truly moral behaviour, since it leads one to seek opportunistically for ways of avoiding penalties.

Concluding remarks

Jennings (2006) warns that one should not automatically equate socially responsible behaviour with good governance and corporate ethics and says that the emphasis on doing good may well be a cover for what goes on internally.

In the final part of this series of papers on business sustainability and ethics to be published next month, we’ll see how sustainability, governance, ethics and legal compliance all fit together.

References


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