Corporate governance as an instrument for ethical behaviour in Organizational success

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ABSTRACT
Corporate governance is leadership that has the rules, processes, or laws by which businesses are operated, regulated, and controlled, the internal factors are defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and government regulations. A corporate governance perspective committed to ethical behaviours in business is very essential for business growth, the organization ethical operations and culture has been on the periphery of corporate governance and board leadership, linked mainly to corporate reputation. However, in today’s globalized and interconnected world, investors and other stakeholders have come to recognize that environmental, social, and governance based on the ethical responsibilities of a company as integral to its performance and long-term sustainability. Internal control procedures and policies implemented by an entity's board of directors must be in line with the values of the organization, audit committee, management, and other personnel to provide reasonable assurance of the entity in achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors in an organization should be able to test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting. The global financial crisis has heightened the need for corporate boards of directors to provide well informed strategic direction and engage in oversight that stretches beyond short-term financial performance. Doing so prepares companies to more comprehensively address risks, by anticipating potentially adverse impacts on people and the environment and managing tangible and reputational risks. It can also generate wealth by creating shareholder value through an increase in business opportunities and broader access to markets. In recent years, corporate governance based on the ethical values has received increased attention because of high-profile scandals involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers. An integral part of an effective corporate governance regime includes provisions for civil or criminal prosecution of individuals who conduct unethical or illegal acts in the name of the enterprise.

Introduction

Overview of corporate governance
Corporations have become powerful and dominant institutions in Kenya and the world at large. They have reached to every corner of the globe in various sizes, capabilities and influences. Their governance has influenced economies and various aspects of social landscape. Shareholders are seen to be losing trust and market value has been tremendously affected. Moreover with the emergence of globalization, there is greater deterioration and less of governmental control, which results is a greater need for commitment (Crane and Matten, 2007). Hence, corporate governance integrated with ethical values has become an important factor in managing organizations in the current global and complex environment. Even though, there is no single accepted definition of corporate governance it can be defined as a set of processes and structures for controlling and directing an organization. It constitutes a set of rules, which governs the relationships. Well-defined and enforced corporate governance provides a structure that, at least in view, works for the benefit of everyone concerned by ensuring that the enterprise adheres to accepted ethical standards as well as to formal laws. To that end, organizations have been formed at the regional, national, and global levels. Corporate governance considers the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executive, and other employees. A sustained thread of discussion regarding governance is the need for corporations to be directed in a responsible and transparent manner in the best interest of the corporation. For profit-oriented corporations with external shareholders, ensuring governance based on the ethical values is intended to increase the confidence of shareholders and capital-market investors.

Keywords
Governance, Ethical values, Clients, Enterprise.
Corporate governance is the system by which companies are directed and controlled (Cadbury Committee, 1992). It involves a set of relationships between a corporation's stakeholders. The potential for conflict of interests between stakeholders can be prevented or mitigated by the processes, customs, policies, laws, and institutions that influence the way a corporation is controlled. An important theme of discussions concerning corporate governance is the nature and extent of commitment of decision makers inside the corporation, and mechanisms that try to decrease the principal agent problem.

The innermost concern of ethical values considers the internal workings of the business and the way in which individuals and colleagues are treated. These practices include: discrimination, confidentiality and issues of loyalty as having implications not just for workers but also for management and even stakeholders. The second concern provides the opportunity to concentrate on the ethics of customer relations and marketing, including the pricing and advertising of goods and services. The third expanding ethical concern focuses attention on relations with other companies, including timely payment of suppliers, working with suppliers who may mistreat their workforce and ethical aspects of mergers and acquisitions and insider trading. Finally, the fourth outer concern considers how a company relates to the locality in which it is situated and covers such topics as self-regulation, cultural diversity, bribery, the physical environment and working with the community.

Such systematic approach to the discipline of the business ethics ensures that all the major business relationships are covered in the principle but allows flexibility to choose examples of ethical issues in each concern as indicated by recent events or current trends. This helps to reinforce the realization that there are ethical 'No-go' areas in business. It also ensures a sense of proportion.

A related discussion thread focuses on the impact of corporate governance ethical systems on organizational efficiency with a strong emphasis on shareholders' welfare; this aspect is particularly present in contemporary public debates and developments in regulatory policy. Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging participation in general meetings. Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, suppliers, local communities, customers, and policy makers. Integrity and ethical behavior: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

Organizations should clarify and make publicly known the roles and of board and management to provide stakeholders with a level of commitment. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, responsibilities factual information.

All parties to corporate governance have an interest, whether direct or indirect, in the financial performance of the corporation. Directors, workers and management receive salaries, benefits and reputation, while investors expect to receive financial returns. For lenders, it is specified interest payments, while returns to equity investors arise from dividend distributions or capital gains on their stock. Customers are concerned with the certainty of the provision of goods and services of an appropriate quality; suppliers are concerned with compensation for their goods or services, and possible continued trading relationships. These parties provide value to the corporation in the form of financial, physical, human and other forms of capital. Turnbull (1997) observes that a rising tide of consciousness about the importance of business ethics is sweeping America and the world. Strategist primarily responsible for ensuring that high ethical principles are espoused and practiced in an organization. All strategic formulations, implementation and evaluation decisions have ethical ramifications. Newspapers and business magazines daily report legal and moral breaches of ethical conduct by both public and private organizations. For example, the Securities and Exchange Commission imposed on MCI (formally world com) a fine of 1.5 billion us dollars payable to shareholders for capital management fraud. MCI stakeholders and bondholders in addition filled civil fraud claims against former C.E.O Bernard Embers, other MCI executives and various banks were involved in the scandal. Managers and employees of the firm must be careful not to become scapegoats blamed for company environmental wrong doings. Harming the natural environment is unethical, illegal and costly. When organizations today face criminal charges for polluting the environment, firms are increasingly turning on their managers and employees to win leniently for themselves. Employee firing and demotions are becoming common in pollution of the environment. Managers being fired at Daring International Inc and Niagara Mohawk power corporations for being indirectly responsible for their firm polluting water exemplify this corporate trend. Therefore, managers and employees must be careful not to ignore, conceal or regard more.

A new way of ethical issues related to product safety, employees health, sexual harassment, AIDS in the workplace, smoking, acid rain, affirmative action, waste disposal, foreign business practice, cover ups, takeover tactics, conflicts of interest, employees privacy, inappropriate gifts, security of the company records and layoffs has accreted the need for strategists to develop a clear code of business ethics. This code can provide a basis on which policies can be devised to guide daily behavior and decisions at the workplace.

**Introduction to corporate governance**

The scope of corporate governance includes nearly all the economic activity of a nation. It was by asking the question, 'Why is not all production carried on by one big firm?' that Coase (1937) laid the foundations for developing a 'view of the firm'. Coase (1937) considered the existence of a 'master and servant relationship', or an 'employer and employee relationship' as a defining feature of a firm. However, this condition would exclude activities carried out by teams, partners, joint ventures, strategic alliances, associations and networks. This led Alchian & Demsetz (1972) to ask the question 'what is meant by a firm?' They concluded that 'The term firm as commonly used is so turgid of meaning that we can not hope to explain every entity to which the name is attached in common or even technical literature'.

In recent years, corporate governance based on the ethical values has received increased attention because of high-profile
scandals involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers. An integral part of effective corporate governance regime includes provisions for civil or criminal prosecution of individuals who conduct unethical or illegal acts in the name of the enterprise. Probably, most purchasing people think of ethical codes as remote from the real world. This may be because work often leaves little time for reflection. The requirement to maintain an unimpeachable standard of integrity in all business relationship is fine until one questions the meaning of integrity is due. What if there is a clash of loyalties between personal and organizational integrity.

It is also a fact that codes of ethics are associated with larger undertakings. In a survey of ethics in management, Brigley considers that codes are easier to introduce and implemented in large organization than in small undertakings where there is generally a preference for informal approaches to ethical issues. Brigley also reports that within organizations, senior management’s attitudes and tactics and conflicts of values with senior management are the most commonly cited obstacles in managing ethical matters. When there is a conflict between employees own or their professional ethical codes and the ethics of organization or their immediate supervisor, employees may have to chose between remaining silent or speaking out and facing consequence of being seen as disloyal. They may even have face to face termination of employment which under conditions of redundancy and restructuring is not to be lightly contemplated.

**Fundamental Corporate governance Perspectives**

The central problem in corporate governance based on the ethical values is to construct the rules and incentives (that is, implicit or explicit 'contracts') to effectively align the behaviour of managers with the desires of principals owners ‘, (Hawley & Williams 1996:21). However, the 'rules' and 'incentives' considered, are generally only those within the existing system of publicly traded firms with unitary boards. The rules and incentives refer to those established by the firm rather than to the legal/political/regulatory system and culture of the host economy or the nature of the owners.

The problem of agents being responsible to agents is that it compounds the agency costs identified by Jensen & Meckling (1976). A basic assumption is that managers will act opportunistically to further their own interests before shareholders. Jensen and Meckling showed how investors in publicly traded corporations incur costs in monitoring and bonding managers in best serving shareholders. They defined agency costs as being the sum of the cost of monitoring management (the agent); bonding the agent to the principal (stockholder/residual claimant'); and residual losses. Their analysis showed amongst other things: why firms use a mixture of debt and equity; why it is rational for managers not to maximize the value of a firm; why it is still possible to raise equity; why capital management reports are provided voluntarily and auditors employed by the company; and why monitoring by security analysts can be productive even if they do not increase portfolio returns to investors.

The value of a firm cannot be maximized because managers possess discretions which allow them to expropriate value to themselves. In an ideal world, managers would sign a complete contract that specifies exactly what they could do under all states of the world and how profits would be allocated. The problem is that most future contingencies are too hard to describe and foresee, and as a result, complete contracts are technologically unfeasible (Shleifer & Vishny 1996). Managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns’ (Donaldson & Davis 1994). Both Lex Donaldson and Davis teach in business schools. Their arguments support the investment of business schools and their students in the development of management skills and knowledge. It also reinforces the social and professional kudos of being a manager.

Donaldson & Davis note that Managers are principally motivated by achievement and responsibility needs and given the needs of managers for responsible, self-directed work; organizations may be better served to free managers from subservience to non-executive director dominated boards. According to Donaldson & Davis, most researchers into boards have had as their prior belief the notion that independent boards are good and so eventually produce the expected findings. There are influential and powerful sources who recommend the need for independent non-executive directors such as the Council of Institutional Investors in the US, Cadbury (1992) in the UK, Australian Institutional investors (AIMA 1995), existing professional directors, and all those would like to become non-executive directors.

Clarkson (1994) states that the firm is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm’s activities. The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services. This view is supported by Blair (1995:322) who proposes the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

Porter (1992:16-17) recommended to US policy makers that they should encourage long-term employee ownership and encourage board representation by significant customers, suppliers, financial advisers, employees, and community representatives. Porter (1992:17) also recommended that corporations seek long-term owners and give them a direct voice in governance (i.e. relationship investors) and to nominate significant owners, customers, suppliers, employees, and community representatives to the board of directors.

The allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how governments favour their various constituencies. The ability of corporate stakeholders to influence allocations between themselves at the micro level is subject to the macro framework, which is interactively subjected to the influence of the corporate sector. The power of directors to control management is dependent upon there being a sufficient number of directors who also have the knowledge and will to act to form a board majority. Even if independent directors have the knowledge to act, they may not have the will and power to act because they are loyal or obligated to management and/or hold their board position at the grace and favour of management. Directors are unlikely to act against management unless they are supported by shareholders. However, many institutional shareholders lack the will to act. This was found to be a major problem for US firms in a report into their competitiveness by Regan (1993). Hawley & Williams (1996:65) noted that
management controlled the information that does reach the board. The result can be a board knowing too little, too late and, even if it is willing to act on a growing problem or crisis, it is often unable to do so. An appropriate separation of powers to create checks and balances provides a way to increase the welfare of stakeholders according to Persson, Roland & Tabillini (1996). Persson, Roland & Tabillini make the point that negative welfare may result if the division of power is not 'appropriate'. An analysis of appropriate division of powers has been made by Bernstein (1980) and Turnbull (1978a;100; 1993b; 1997c).

All suggestions for reform of corporate governance to be based on the ethical values need to consider the power of agents to act, or be subject to a veto, when there is a compound board. Pound (1993a) makes the points: always have an opposition view and there must be an opposition party and the prospect of insurgency. However, Pound (1993a) does not consider the principle of a division of power in corporate governance based on the ethical values, even though he participated as co-chair of the shareholders' committee established at USX for this purpose (Pound 1992). While the power perspective of the firm may be but a part of the corporate governance, it should never be neglected because without the power to take corrective action, no action can take place.

For any action to be appropriate, the actors also need information which is accurate, timely, sufficient and yet manageable. While Pound (1993a) talks about 'feedback' it is from institutional investors who do not, cannot, and should not, have firm specific inside expert information. This leads us to consider the cybernetic approach to corporate governance based on the ethical values.

The view and practice of self-regulation and self-governance based on the ethical values has been used since governors were used in the 19th century to control the speed of steam engines. However, little of this knowledge appears to have been researched, let alone applied to social institutions or to the role of government. The Vice President of the US suggested that the reason for this gap in the application of knowledge of the 'information age' is that only nine of the 535 members of Congress have any professional education in technology (Gore 1996). Another reason could be that social scientists are not sufficiently familiar with the view and practice of self-regulation to understand why it cannot work with the dominant form of institutional investors who do not, cannot, and should not, have firm specific inside expert information. This leads us to consider the cybernetic approach to corporate governance based on the ethical values.

Ignorance in the view and practice of self-regulation is so widespread among social commentators and scientists that they assert that it cannot work for institutions in a market economy. Ironically, many of the same people support a market system because they believe that it is self-regulating. Design guidelines for establishing a 'self-managing self-correcting power structure', without markets, for Aboriginal firms are suggested by Turnbull (1978a:100).

The need for government bureaucracies to intercede as corporate regulators arises because those adversely affected by a firm may not have the information, power and will to correct the problem. Stakeholder participation in governance based on the ethical values provides a way of reducing this deficiency. If the interests of the participating stakeholders are not sufficiently wide to reflect the concerns of the host society, some government interventions will still be required. However, stakeholder participation may also be required in government bureaucracies to allow policies to be mediated to suit local conditions and performance standards established and evaluated by those affected (Turnbull 1994d, 1995b). There are arguments and evidence to suggest that self-regulation and self-governance based on the ethical values provide operating advantages for social institutions generally and competitive advantages for firms (Turnbull 1997c, e).

Ethical views of Corporate governance

Business ethics deals with ethical business activities, decisions and situations where the right and wrongs are addressed. The main reasons for this are the power and influence of business in any given society is stronger than ever before. Businesses have become a major provider to the society, in terms of jobs, products and services. Business collapse has a greater impact on society than ever before and the demands placed by the firm’s stakeholders are more complex and challenging. Only a handful of business giants have had any formal education on business ethics but there seems to be more compromises these days. Business ethics helps us to identify benefits and problems associated with ethical issues within the firm and business ethics is important as it gives us a new light into present and traditional view of ethics (Crane and Matten, 2007). In understanding the ‘right and wrongs’ in business ethics, Crane & Matten, (2007) injected morality that is concerned with the norms, values and beliefs fixed in the social process which helps right and wrong for an individual or social community.

Ethics is defined as the study of morality and the application of reason which sheds light on rules and principle, which is called ethical views that ascertains the right and wrong for a situation. Whilst business ethics view focuses on the ‘rights and wrongs’ in business, feminist ethics View emphasizes on empathy, healthy social relationship, loving care for each other and the avoidance of harm. In an organization, to care for one another is a social concern and not merely a profit centered motive. Ethics has also to be seen in the light of the environment in which it is exercised.

This is important as an organization is a network of actions, hence influencing transcommunal levels and interactions (Casey, 2006). On the other end, discourse ethics view is concerned with peaceful settlement of conflicts. Discourse ethics, also called argumentation ethics, refers to a type of argument that tries to establish ethical truths by investigating the presuppositions of discourse (Habermas, 1996). Meisenbach (2006) contends that such kind of settlement would be beneficial to promote cultural rationality and cultivate openness. Virtue ethics view focuses on moral excellence, goodness, chastity and good character. Virtue is a state to act in a given situation. It is not a habit as a habit can be mindless (Annas, 2003). Aristotle calls it as disposition with choice or decision. For example, if a board member decides to be honest, now that a decision which he makes and thus strengthens his virtue of honesty. Virtue involves two aspects, the affective and intellectual. The concept of affective in virtue view suggests “doing the right thing and have positive feelings”, whilst, the concept of intellectual suggests “to do virtuous act with the right reason”. Virtues can be instilled with education. Aristotle mentions that knowledge on ethics is just like becoming a builder (Annas, 2003). Through the process of educating and exposure to good virtues, the development of ethical values in a child’s life is evident. Hence, if a person is exposed to good or positive ethical standards, exhibiting
honesty, just and fairness, than he would exercise the same and it will be embedded in his will to do the right thing at any given situation. Virtue Ethics is eminent to bring about the intangibles into an organization. Virtue ethics highlights the virtuous character towards developing a morally positive behavior (Crane and Matten, 2007).

Virtues are a set of traits that helps a person to lead a good life. Virtues are exhibited in a person’s life. Aristotle believed that virtue ethics consists of happiness not on a hedonistic sense, but rather on a broader level. Nevertheless, postmodern ethics view goes beyond the facial value of morality and addressed the inner feelings and ‘gut feelings’ of a situation. It provides a more holistic approach in which firms may make goals achievement as their priority, foregoing or having a minimal focus on values, hence having a long term detrimental effect. On the other hand, there are firms today who are so value driven that their values become their ultimate goal (Balasubramaniam, 1999)

Conclusion
This review has seen corporate governance based on the ethical values addresses the cause and effect of variables, such as the configuration of board members, audit committee, independent directors and the role of top management. In addition, ethics in business have been closely associated with corporate governance. This can be seen with the association of business ethics view, feminist ethics view, discourse ethics view, virtue ethics view and postmodern ethics view. Hence, it can be argued that corporate governance based on the ethical values is more of a social relationships rather than process orientated structure. In addition, the paper focused on the view that the shareholders’ aimed to get a return on their investments. In today’s business environment, business process should also focus on other critical factors such as legislation, culture and institutional contexts. Corporate governance is constantly changing and evolving and changes are driven by both internal and external environmental dynamics. The internal environment has a fixed mindset of shareholders’ relationship with stakeholders and maximizing profits. Whilst, issues in the external environment such as the breakup of large conglomerates like Enron, mergers and acquisitions of corporation, business collaborations, Easier financial funding, human resource diversity, new business start-ups, globalization and business internationalization, and the advance of communication and information technology have directly and indirectly caused the changes in corporate governance based on the ethical values. The current corporate governance views cannot fully explain the complexity and heterogeneity of corporate business.

Goverance for different corporations varies due to its cultural values, political and social and historical circumstances. In this sense, governance based on the ethical values for developed organization can vary due to the culture and economic contexts of individual organization. Moreover, effective and good corporate governance based on the ethical values cannot be explained by one view but it is best to combine a variation of views, addressing not only the social relationships but also emphasize on the rules and legislation and stricter enforcement surrounding governance practice and going beyond the norms of a mechanical approach towards corporate governance. Literature has proven that even with strict regulations, there have been infringements in corporate governance. Hence it is crucial that a holistic realization be driven across the corporate world that would bring about a different perspective towards corporate governance based on the ethical values. The days of cane and bridle are becoming a mere shadow and the need to get to the root of a corporation is essential. Therefore, it is important to re-visit corporate governance based on the ethical values in the light of the convergence of these views and with a fresh angle, which has a holistic view and incorporating subjectivity from the perspective of social sciences.

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