6 Ethics, corporate governance and corporate behavior

6.1 Introduction

Ethics is not new for people in business. The corporate world has always had some rules, standards and norms for doing business. However these are generally changing with some social and cultural basis which can be different country by country, even though we might expect universal rules. When the company applies these standards or norms as a part of its responsibility we can call them an ethical code of conduct of business. Moreover ethics is also inevitably a part of business responsibility. Corporate behaviour should be ethical and responsible; that is why corporate promises for their shareholders and stakeholders have to behave fair, ethical and equitable. And of course ethics is inevitably related to governance

6.2 Defining ethics

Ethics shows a corporation how to behave properly in all its business and operations. However, business ethics is characterised by conflicts of interests. Businesses attempt to maximize profits as a primary goal on one hand while they face issues of social responsibility and social service on the other. Ethics is the set of rules prescribing what is good or evil, or what is right or wrong for people. In other words, ethics is the values that form the basis of human relations, and the quality and essence of being morally good or evil, or right or wrong. Business Ethics means honesty, confidence, respect and fair acting in all circumstances. However, such values as honesty, respect and confidence are rather general concepts without definite boundaries. Ethics can also be defined as overall fundamental principles and practices for improving the level of wellbeing of humanity.

Ethics is the natural and structural process of acting in line with moral judgments, standards and rules. Being a concrete and subjective concept, "business ethics" can be discussed with differing approaches and in varying degrees of importance in different fields. Indeed, it is highly difficult to define ethics and identify its limits and criteria. Accordingly, there are difficulties in discussing this concept in literature as it is ubiquitous in business life, at the business level, and in human life. According to what, how, how much and for whom ethics is or should be are important questions. It is not always easy to find answers to these questions (Aras & Crowther 2008a).

A business which does not respect ethical criteria and fails to improve them will disrupt its integrity and unity, i.e., its capacity to achieve its goal, and will lead to internal or external conflicts. Business ethics is the honest, respectful and fair conduct by a business and its representatives in all of its relations. A predicate question to the role of ethics in business is the question of why businesses engage in ethical practices. Some authors, notably Milton Friedman (1962), would strongly deny that a business has a responsibility to any group but the firm's shareholders.

To initiate corporate giving, for example, would be a fiduciary breach of management in Friedman's opinion: an agent for a principal is neither legally nor morally permitted to give away or "waste" the principal's capital (Joyner & Payne, 2002). Milton Friedman also argued that 'there is only one social responsibility of business – use its resources and engage in activities designed to increase its profits so long as it … engages in open and free competition without deception and fraud' (Friedman, 1962).

However, ethical behaviour and ethical business has effects not only on stakeholders, and shareholders but also on the entire economy. We believe that when we act ethically in business decision-making process this will ensure more effective and productive utilization of economic resources.

6.3 Ethical philosophies

One component of the change to a concern with social responsibility and accountability has been the recognition (or reinstatement) of the importance of ethics in organisational activity and behaviour. In part this can be considered to be a recognition of the changing societal environment of the present time and in part a recognition of the problems brought about through corporate activity taken without any account of ethical implications. Among such activity can be seen the many examples of pollution (for example Union Carbide at Bhopal. India or the Exxon Valdiz oil spill or BP in the Mexican Gulf) and greed such as the Enron incident. These have caused a rethinking of the role of ethics in organisation theory.

Ethics is however a problematical area as there is no absolute agreement as to what constitutes ethical (or unethical) behaviour. For each of us there is a need to consider our own ethical position as a starting point because that will affect our own view of ethical behaviour. The opposition provided by deontological ethics and teleological ethics (regarding the link between actions and outcomes) (see below), and by ethical relativism and ethical objectivism (regarding the universality of a given set of ethical principles) represent key areas of debate and contention in the philosophy of ethics. This provides a starting point for our consideration of ethics.

6.3.1 Deontological Ethics

According to deontologists certain actions are right or wrong in themselves and so there are absolute ethical standards which need to be upheld. The problems with this position are concerned with how we know which acts are wrong and how we distinguish between a wrong act and an omission. Philosophers such as Nagel argue that there is an underlying notion of right which constrains our actions, although this might be overridden in certain circumstances. Thus, there may be an absolute moral constraint against killing someone, which in time of war can be overridden.

6.3.2 Teleological Ethics

Teleological theory distinguishes between 'the right' and 'the good', with 'the right' encompassing those actions which maximise 'the good'. Thus it is outcomes which determine what is right, rather than the inputs (*i.e.* our actions), in terms of ethical standards. This is the viewpoint which is promoted by Rawls in his 'A Theory of Justice'. Under this perspective, one's duty is to promote certain ends, and the principles of right and wrong organise and direct our efforts towards these ends.

6.3.3 Utilitarianism

Utilitarianism is based upon the premise that outcomes are all that matter in determining what is good and that the way in which a society achieves its ultimate good is through each person pursuing his / her own self interest. The philosophy states that the aggregation of all these self interests will automatically lead to the maximum good for society at large. Some Utilitarians have amended this theory to suggest that there is a role for government in mediating between these individual actions to allow for the fact that some needs can best be met communally.

6.3.4 Ethical Relativism

Relativism is the denial that there are certain universal truths. Thus, ethical relativism posits that there are no universally valid moral principles. Ethical relativism may be further subdivided into: 'conventionalism', which argues that a given set of ethics or moral principles are only valid within a given culture at a particular time; and 'subjectivism', that sees individual choice as the key determinant of the validity of moral principles.

According to the 'conventional' ethical relativism it is the mores and standards of a society which define what is moral behaviour and ethical standards are set, not absolutely, but according to the dictates of a given society at a given time. Thus if we conform to the standards of our society then we are behaving ethically. We can see however that ethical standards change over time within one society and vary from one society to another; thus the attitudes and practices of the 19th century are different to our own as are the standards of other countries.

A further problem with this view of ethics is that of how we decide upon the societal ethics which we seek to conform to. Thus there are the standards of society at large, the standards of our chosen profession and the standards of the peer group to which we belong. For example, the standards of society at large tend to be enshrined within the laws of that society. But how many of us rigorously abide by the speed limits and traffic laws of our country?

Different grouping within society tend to have different moral standards of acceptable behaviour and we have a tendency to behave differently at different times and when we are with different groups of people. Equally when we travel to a foreign country we tend to take with us the ethical standards of our own country rather than changing to the different standards of the country which we are visiting. Thus it becomes very difficult to hold to a position of ethical relativism because of the difficulty of determining the grouping to which we are seeking to conform.

6.3.5 Ethical Objectivism

This philosophical position is in direct opposition to ethical relativism; it asserts that although moral principles may differ between cultures, some moral principles have universal validity whether or not they are universally recognised. There are two key variants of ethical objectivism: 'strong' and 'weak'. Strong ethical objectivism or 'absolutism' argues that there is one true moral system. Weak ethical objectivism holds that there is a 'core morality' of universally valid moral principles, but also accepts an indeterminate area where relativism is accepted.

6.3.6 Concluding remarks

We can see that each of these theories of ethics is problematical and that there is no overarching principle which determines either what is ethical or what is not. Nevertheless a concern with ethics has been introduced explicitly into organisation theory and strategy in recent years. This has led to an increased interest in Corporate Social Responsibility.

6.4 Corruption

One issue which is of concern in the Western world is the question of corruption. This has been exhibited at a governmental level for many years and Transparency International produce an annual list to show how corrupt various countries are. In the 2010 list Demark is the least corrupt country while failed states such as Somalia and Afghanistan are at the bottom. From a corporate point of view however the problem is that in certain countries it is necessary to offer payments in order to do business and the debate is concerned with the extent to which it is ethical to do so. We do not offer an answer to this question – there is no definitive answer. Instead we simply point out that under certain governance codes and certain ethical philosophies it is reasonable but under others it is not. The salient point however is that Western values do not easily translate to every other part of the world.

6.4.1 ISO 26000

One of the most certain definitions found in ISO 26000 is that declared the importance of ethical behaviour. This standard has defined ethical behaviour as: behaviour that is in accordance with accepted principles of right or good conduct in the context of a particular situation and is consistent with **international norms of behaviour.**

International norms of behaviour, although already agreed to, are always condemned by some countries. These are the countries with similar interests who show their unwillingness to abide by ethical behaviour when it is time to vote on a related standard, or when the world celebrates a Nobel peace prize winner from China.

We must remember however that international standards are a problematic concept as there are very few universally agreed upon standards and it is very easy therefore to assume that Western norms have international agreement.

6.5   Culture

Culture can be defined as a set of shared attitudes, values and beliefs which are based to a large extent upon common backgrounds and experiences. They determine such things as our understanding of appropriate behaviour and reacting to circumstances. Similarities in culture lead towards similar behavioural patterns whereas differences in culture lead to differences – and these differences are a source of misunderstanding. This cultural component of corporate behaviour sets the tone of governance systems in a way which is very complex and is based in part upon the different systems described earlier. We consider that cultural differences are normally excluded from any analysis of governance but these differences mean that any universal code is applied so differently in different cultures as to render the code almost meaningless. In other words we maintain that culture is the most important determinant of the operation of any system of governance.

6.6   The Gaia Theory

While theorists of organisations were developing the notion of greater accountability to stakeholders during the 1970s, other developments were also taking place in parallel. Thus in 1979 Lovelock produced his Gaia Hypothesis in which he proposed a different model of the planet Earth; in his model the whole of the ecosphere, and all living matter therein, was co-dependant upon its various facets and formed a complete system.

According to this hypothesis, this complete system, and all components of the system, were interdependent and equally necessary for maintaining the Earth as a planet capable of sustaining life. This Gaia hypothesis was a radical departure from classical liberal theory which maintained that each entity was independent and could therefore concentrate upon seeking satisfaction for its own wants, without regard to other entities. This classical liberal view of the world forms the basis of economic organisation, provides a justification for the existence of firms as organs of economic activity and provides the rationale behind the model of accounting adopted by society. The Gaia hypothesis however implied that interdependence, and a consequent recognition of the effect of ones actions upon others, was a facet of life. This consequently necessitates a different interpretation of accountability in terms of individual and organisational behaviour.

Given the constitution of economic activity into profit seeking firms, each acting in isolation and concerned solely with profit maximisation, justified according to classical liberalism, it is perhaps inevitable that organisation theory developed as organisation-centric, seeking merely to manage the activities of the firm insofar as they affected the firm. Any actions of the firm which had consequences external to the firm were held not to be the concern of the firm.

Indeed enshrined within classical liberalism, alongside the sanctity of the individual to pursue his own course of action, was the notion that the operation of the free market mechanism would mediate between these individuals to allow for an equilibrium based upon the interaction of these freely acting individuals and that this equilibrium was an inevitable consequence of this interaction. As a consequence any concern by the firm with the effect of its actions upon externalities was irrelevant and not therefore a proper concern for its managers.

The Gaia hypothesis stated that organisms were interdependent[16] and that it was necessary to recognise that the actions of one organism affected other organisms and hence inevitably affected itself in ways which were not necessarily directly related. Thus the actions of an organism upon its environment and upon externalities was a matter of consequence for every organism. This is true for humans as much as for any other living matter upon the planet. It is possible to extend this analogy to a consideration of the organisation of economic activity taking place in modern society and to consider the implications for the organisation of that activity. As far as profit seeking organisations are concerned therefore, the logical conclusion from this is that the effect of the organisation's activities upon externalities is a matter of concern to the organisation, and hence a proper subject for the management of organisational activity.

While it is not realistic to claim that the development of the Gaia Theory has had a significant impact upon organisational behaviour, it seems perhaps overly coincidental to suggest that a social concern among business managers developed at the same time that this theory was propounded. It is perhaps that both are symptomatic of other factors which caused a re-examination of the structures and organisation of society. Nevertheless organisational theory has, from the 1970s, become more concerned with all the stakeholders of an organisation, whether or not such stakeholders have any legal status with respect to that organisation.

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6.7   Corporate Behaviour

Corporate behaviour is important for company success both financially and concerning the relationship between corporate and business interests (stakeholders). We cannot define corporate behaviour without an ethical and CSR base in order to refer to that behavioural aspect. Corporate behaviour involves legal rules, ethical codes of conduct and social responsibility principles (figure1). In other words corporate behaviour is based on all of these components and involves law, ethics and CSR. It is important to recognize also that this behaviour must be ethical but must also be seen to be ethical – perceptions are very important.

Corporate behaviour has effects not only on stakeholders and shareholders but also on the entire economy. When a corporation acts ethically and socially responsibly in its business decisions and strategic planning then that corporation will be more sustainable. As we have seen socially responsible corporate behaviour is increasingly seen as essential to the long term survival of companies.
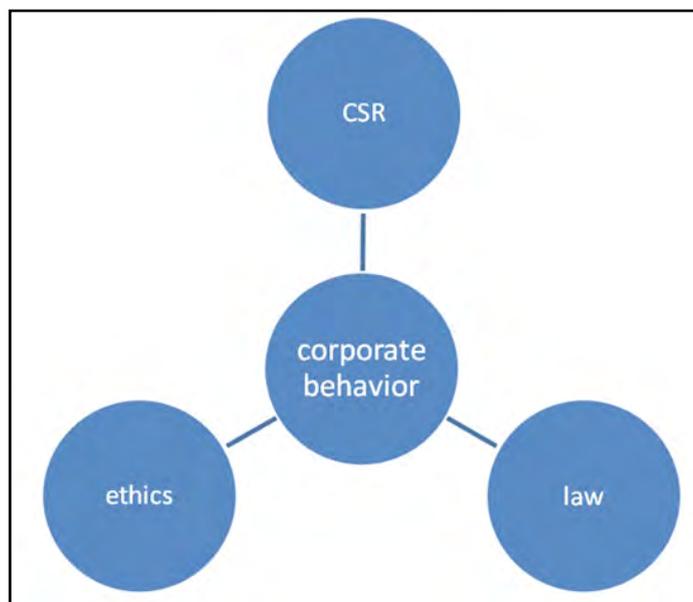

Figure 6.1 The components of Corporate behaviour

6.8   Governance, Ethics and Corporate Behaviour

At this broader level governance and CSR are very interconnected. Carroll (1979: 500) describes CSR in these terms: "the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time". After his definition, in 2002 Whetten et al. defined CSR as "societal expectations of corporate behavior; a behavior that is alleged by a stakeholder to be expected by society or morally required and is therefore justifiably demanded of a business" (p. 374). Following from the first definition, the CSR definition expanded and covered more corporate behaviour and stakeholder expectation. On the other hand some broad terms – especially society – have been narrowed to stakeholders.

Corporate behaviour toward the stakeholders is becoming a much more important concept in practice and a central part of corporate governance. Corporate behaviour is an important concept because it has to be ethical, legal, and responsible behaviour for organizations, stakeholders and society. This aspect of the corporate behaviour has more benefit for society also and so that is why it is more related with ethics and CSR as well as with governance. We have of course referred to stakeholders in other chapters and this is an increasingly important aspect of governance.

To be a socially responsible corporation, a company must be more than a legal and ethical person also. CSR is not always a legal necessity; increasingly it is an obligation. However a company has to be socially responsible even though it is not a legal obligation (Aras & Crowther 2008b) – which is one of the most important characteristics of CSR. These provide the platform upon which social responsibility is built.

6.9 Corporate Reputation

One concept which is of growing importance for business management is that of corporate reputation. The beginning of the twenty-first century creates a new challenge for corporations – realising the potential of their corporate brands. In today's markets organisations focus on intangible factors in order to compete and differentiate their services/products in an environment, which is characterised by rapid changes. The reputation of the corporation is often the most important factor in gaining a competitive advantage as well as building financial and social success.

Corporations are realising that possessing a well-known name such as Johnson & Johnson, can help them secure a good position in the marketplace. Businesses are not only faced with sophisticated and informed stakeholders but also by rigorous regulation and evolving standards as well as by independent associations and agencies that act as watchdogs guarding the interests of their publics.

There are many benefits claimed for being perceived as having a good corporate reputation. One of the main is concerned with the fact that it improves shareholder value; a strong corporate reputation inspires confidence in investors, which in turn leads to a higher stock price for a company. It brings increased customer loyalty to the products of the company. A positive customer perception of a company extends to its products. Equally a strong corporate reputation is an influential factor for forming partnerships and strategic alliances as the partner company has the potential to improve its own reputation by association. Similarly a company with a solid reputation is more influential on legislative and regulatory governmental decision-making.

Employee morale and commitment are higher at corporations with a good corporate reputation. At a time of a crisis a good corporate reputation can shield the company from criticism and even blame, and can help it communicate its own point of view more easily to audiences that are willing to listen to its point of view. A good example is the Pepsi Cola tampering case according to which products on sale were found to contain material injected by hypodermic syringes. Pepsi dealt effectively with the crisis by defusing public alarm with a public relations campaign that highlighted the integrity of its manufacturing process and its corporate credibility.

6.10 Conclusion

Ethical behaviour and ethical business has effects not only for stakeholders, and shareholders but also on the entire economy. We believe that when acting ethically in the business decision-making process then this will ensure more effective and productive utilisation of economic resources. Corporate behaviour affects responsible and proper economic and institutional improvement. It will be also an influence on all society and a common benefit. Thus corporate governance can be seen to have an effect outside of the corporation itself as it affects society at large and the relationship between the corporation and society, and therefore all stakeholders.

Additionally we can make the following points:

- Organizations affect the external environment - businesses and the wider global environment
- The Gaia hypothesis shows that the whole ecosphere forms a complete system, unlike classical liberal theory which postulates the independence of each entity
- From 1970 there have developed theories and regulations to include all stakeholders inside and outside the organisation

- Corporate reputation is an increasingly important factor for organisations
- Ethics has been reinstated as a standard for organisational activity
- Corporate governance as a subject indicates an increasing concern with social and environmental effects of organisational behaviour and not merely financial performance.

6.11 References

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6.12 Further Reading

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6.13 Self-test Questions

1. What are the responsibilities of business in their corporate decisions?
2. Why does a company have to be ethical?
3. What is the relationship between CSR and corporate behaviour?
4. Is corporate governance a legal necessity? Why?
5. Why is corruption a problem for corporations?