

Ethical Challenges to the Governance Practices of Corporate Leaders in the 21st Century

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ABSTRACT

Ethics has become an important component of corporate governance. Corporate governance decisions about engagement in corporate social responsibility are addressed by many researchers as a corporate issue determined for the most part by strategic motives and somewhat less by altruism. However, it is the leaders of organisations who make the choices about strategic positioning, and how they direct people and resources can influence corporate objectives such as those concerning corporate social responsibility. The purpose of this paper is to consider why corporate social responsibility is a legitimate responsibility for the leaders of companies and to explore how some ethical theories can explain the involvement of leaders in CSR issues. The paper discusses what is meant by corporate social responsibility, why corporate leaders are increasingly supporting CSR and the extent to which the major ethical theories assist corporate leaders to make ethical decisions about CSR. It addresses the questions: What does corporate social responsibility mean? Do corporate leaders have social responsibilities for stakeholders, including responsibilities to consumers, employees and government, and to society? If a corporation is more than a profit-making institution, what is the ethical and moral basis of its responsibilities, and to what extent do ethical theories assist corporate leaders in making ethical decisions about corporate social responsibility? The paper shows that the traditional ethical theories of ethical egoism, teleology and deontology appear to offer inadequate guidance for leaders who operate in complex environments and face complex problems. It concludes that a challenge for researchers is to provide ethical models that can assist leaders manage the moral dilemmas emerging from decisions involving the multiple stakeholders in corporate social responsibility issues.

KEY WORDS: ethics, corporate social responsibility, ethical leadership

INTRODUCTION

The increased focus on ethics as part of corporate governance was demonstrated by the Cadbury (1992) and Hampel (1997) Committees (in the UK), the OECD (1998) in Europe, the requirements of the Australian Stock Exchange (ASX, 2003, Bosch, 1995; Hilmer, 1993) and recently by the recently released Governance Standards by Standards Australia International (2003). Francis (2000, p.9) described the connection between governance and ethics:

“Corporate governance, as a term, has come to imply good, in the non-moral as well as the moral sense. Its non-moral applications include efficient decision making, appropriate resource allocation, strategic planning, and so on. In its moral sense good corporate governance has come to be seen as promoting an ethical climate that is both morally appropriate in itself, and

consequentially appropriate in that ethical behaviour in business is reflected in desirable commercial outcomes. Here the links are with due diligence, directors' duties, and the general tightening of corporate responsibility”.

A wealth of research has explored the disclosure of the corporate governance practices adopted by companies in relation to their corporate social responsibilities (CSR) (Armstrong and Sweeney 2002, Francis and Armstrong 2001; Armstrong et al 2001).

Less well investigated is the degree to which the support of corporate leaders for CSR principles and practices depend on their ethics and values. The ethics and values of corporate leaders is an important issue because the more senior the leaders, the more impact they have on those who work for them as well as on other stakeholders in their organisations including society at large. The purpose of this paper is to consider why corporate social responsibility is a legitimate responsibility for the directors of companies and to explore how some ethical theories can explain the involvement of leaders in CSR issues. It addresses the questions: What does corporate social responsibility mean? Do corporate leaders have social responsibilities? If a corporation is more than a profit-making institution, what is the ethical and moral basis of its responsibilities, and to what extent do ethical theories assist corporate leaders in making ethical decisions about corporate social responsibility?

CORPORATE SOCIAL RESPONSIBILITY

As early as 1953 Bowen (cited in (Buchholtz 1995) defined it as: “it refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society”. Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society. In particular, according to the World Business Council for Sustainable Development (WBCSD, 1998) this means acting with responsibility in its relationships with other stakeholders, not just shareholders.

The multifaceted concept of corporate social responsibility includes intentions (moral or amoral), preventative and anticipatory actions, and social responsiveness (taking action, performance and accountability). CSR actions and responses refer to business conduct (legal compliance, corruption and bribery, political activities, whistleblowers, competitive conduct, etc.), environment, human rights (health and safety, child labour, forced labour, indigenous people's rights, etc), consumers (product safety, quality, privacy, recalls, etc), workplace/employees (nondiscrimination, training, downsizing, harassment, etc), (Business for Social Responsibility, 2000); community involvement and partnerships, sponsorships or cause related marketing (that is, branding the company by linking it with community needs, eg. computer literacy with information technology companies) and philanthropy (Business Council of Australia, 2000). The term is also used when referring to ethical investment or sustainability.

Ethical investment or Socially Responsible Investment (SRI), (for example, not investing in such entities concerned with tobacco, alcohol and gambling or investing in companies demonstrating concern for the environment), is a well-established,

major investment sector in the US, the UK and Europe and Australia. In the US, 13% of the \$16.3 trillion in investment assets, is invested in socially responsible funds and they have consistently outperformed the market average (KPMG 2001)

Sustainable development refers to more than concern for the physical environment. In the context of this paper, it is about managing environmental, social and economic outcomes for the benefit of all stakeholders. There are various opinions concerning who corporate stakeholders are apart from shareholders (Freeman 1984; Davenport 2000). The WBCSD (1999) lists stakeholders as those affected by or those affecting a business's activities including representatives from labour organisations, academia, church, indigenous peoples, human rights groups, government and non-government organisations. The priority areas that should be addressed for sustainable development were human rights, employee rights, environmental protection, supplier relationships, community involvement and stakeholder rights.

The idea that businesses have corporate social responsibilities is increasingly recognised in both the academic literature and in business practice. Of interest here is not so much the business responses to CSR, but the motivation for that response. In particular, what motivates corporate leaders to support, or not support, CSR and to what extent can these motivations be explained by ethical principles.

WHY DO CORPORATE LEADERS SUPPORT CSR?

Motivation theory suggests that people behave in certain ways because of the goal to be achieved, (desirability of and evaluation that the goal can be achieved, information about the goal), social pressures (communication and pressures from others), and personal attributes (beliefs, attitudes and values). Hemingway and Maclagen (2004) argue that, where managers have the discretion to initiate change, their individual personal values are among the factors that explain the formulation, adoption and implementation CSR policies in organisations. Personal need for achievement is also an important motive for leaders (McClelland 1961) and higher order needs (eg. ethical and moral ideals) are seen as desirable when lower order needs have been satisfied (Maslow 1970).

The traditional view of the goal of business is that it is there to make a profit. However, debates occur in the press every day about the trade offs between ethical governance principles and shareholder returns. While some see the only responsibility of business as that of supplying goods and services to society at a profit for their shareholders, others see business operating for the welfare of society as a whole and support the view that, as business is the third great institution of society after government and law, its social responsibilities encompass every aspect of business operations from the products companies make and the services they deliver to the relationships they have with employees, customers, suppliers and the communities in which they operate (Business for Social Responsibility, 2000; Quazi, 2000). Furthermore, Birch (1998) suggests that a business, corporation, or business-like organisation, has social, cultural and environmental responsibilities to the community in which it seeks a 'licence to operate', as well as economic and financial ones to its shareholders or 'immediate' stakeholders.

Meeting such responsibilities demands communication with the stakeholders. All publicly listed companies are required to produce an Annual Report for their shareholders. In Australia, the Annual Report must contain financial information, corporate governance information and a company's policy on the establishment and maintenance of appropriate ethical standards. Increasingly, the Annual Report in addition to financial reports also includes reports on the social and environmental aspects of a business, ie, the Triple Bottom Line (TBL), providing information that is of interest, not only to shareholders, but to other stakeholders (Sweeney and Estes, 2000, Sweeney et al 2001). In their summary and comparison of various international CSR reporting standards, Business for Social Responsibility (2000, p.2) pointed out "The increased interest in CSR has been paralleled by substantial growth in the number of external standards produced for business by governmental, non-governmental, advocacy and other types of organisations. These various standards are designed to support, measure, assist in implementation, and enhance accountability for corporate performance on CSR issues". Significant among the Australian standards are those published by Standards Australia (SAI 2003, AS 8000-8003) which set out the essential elements for establishing, implementing and maintaining an effective Corporate Social Responsibility program within business, government and non-government entities. In one of two companion volumes to the Standards, Armstrong and Francis (2004a,b) have provided checklists for companies to use to assess their compliance with the principles underlying the standards. Many standards include requirements for assessments of the reliability of measures, external verification and transparency of information.

Among the forces driving the current interest in CSR are increasing societal concerns about the role of corporations in globalisation, sustainable development and social equity issues in regard to the growing gap between rich and poor (Bendell 2000). At the heart of the conflict surrounding the meetings of the World Economic Forum are concerns about the ethical decisions of corporate executives. Globalisation is also forcing companies to be clear about their ethical position and about how their values fit with those from other cultures. An example is how the protest, led by Oxfam and Medecins Sans Frontieres over the drug industry's exclusive patents on life saving drugs and control of prices that inhibit access by third World countries, forced the companies to back down and develop new pricing policies (O'Loughlan 2001)

In other cases, factors associated with long term profit are driving corporate interest in CSR (Peters 1999). Investors and consumers are taking a much greater interest in the reputation and credibility of corporations (Tomasic and Bottomly 1993). Various reputation indices (Dow Jones Sustainability Index, Fortune Reputation Survey, The Good Reputation Index of Australian Companies) measure perceptions of CSR that have an impact on public perceptions of corporations. Companies, which may have been criticised in the past for not recognising their social responsibilities are taking a new look at business practices. Shell is one corporation that has seriously addressed this issue by distributing its 9 Business Principles, (endorsed by the board as a guide to ethical business behaviour), and training people in its use in 119 countries in 51 languages. In their most recent report on the implementation of the principles, Shell (2000,p.25) reported the termination of 106 contracts and two ventures with suppliers "because of operations that are not compatible with our Principles, mostly Principle 6 - Health, safety and the environment (HSE) and Principle 4 - Business integrity".

It is not only social pressure that drives the interest in CSR. Whether it is driven by enlightened self-interest or ethical concerns, “Valuing intangible assets such as reputation, employee loyalty and community support is increasingly part of a broadly defined assessment of commercial returns and business sustainability ... Social Involvement can be seen as a way to pursue profits” (Business Council of Australia, 2000, p.29). Research (Berman, et al 1999) supports this contention. From either a moral or a profit perspective, it appears that company directors can no longer afford to ignore the long-term costs and benefits of ethical governance practices.

The conclusion from the above discussion is that corporate social responsibility requires corporate leaders to act responsibly and make ethical decisions in the interests of both corporations and society. Not so clear is the extent to which individual CSR decisions are motivated by social pressures, the reality of making a profit, a sense of personal achievement, or whether such decisions are a response to an ethical concern for the welfare of society. Whatever the motivation, it appears that corporate leaders will increasingly be faced with CSR decisions. This raises the question: to what extent do ethical theories assist corporate leaders to make ethical decisions? Three major types of ethical philosophical theories attempt to explain the motivation of individual decision makers: egoism, teleology and deontology.

ETHICAL THEORIES AND CORPORATE SOCIAL RESPONSIBILITY

Ethical egoism is a theory that states that an individual should follow the greatest good for oneself. People who use an egoistic criterion to make ethical decisions are exclusively concerned with self-interest. This theory is said to support the Friedman (1962) argument that the only responsibility of corporations is an economic return to their shareholders. Bribery, (for example, paying a buyer to facilitate a tender or purchase of products) can also be justified under this theory even though it may result in harm to consumers or depriving owners of rightful profits. Kanunngo and Mendonca (1996) contrast hedonistic and vindictive egoism which causes harm to others and self (I will take you down with me, P.40) with genuine altruism (when concern for others may result in loss to oneself). They suggest that the values inherent in the choice of “others before myself” are universal and form part of the heritage of all cultures. For these reasons, egoistic theories are not considered a desirable basis for motivation.

Comparing teleology and deontology: teleology concentrates on the consequences of actions and deontology concentrates on the correctness of the intentions of the decision maker and the means chosen to accomplish a task.

The most well known teleological theory, utilitarianism, suggests that the right action is the one that generates the greatest good for the greatest number and minimises the damage or harm to others. What makes an action right or wrong is the good or evil that is produced by the act, not the act itself. Thus, teleological theories do not hold that an act has intrinsic value in and of itself, but that all acts and practices must be evaluated in terms of the good or bad consequences they produce (Buchholtz 1995). This theory appeals to the business community because of the cost-benefit approach to decision making and is said to support the contention that “the end justifies the means”. However, it fails to protect the rights of minorities. Hence, minorities may

suffer in the process of producing the greatest happiness for the greatest number. (From this point of view, large mining companies would justify their operations in rural underdeveloped countries that have an undesirable impact on local communities). It ignores good intent and values and leaves unresolved the question of whose values determine the greatest good.

Deontological theories address duty and moral obligation. Factors other than the outcomes determine the rightness or wrongness of actions and practices. Principle and the intention to achieve the most equitable decision for all individuals concerned guide people's decisions. "Doing one's duty is a matter of satisfying the legitimate claims or needs of others as determined by applicable moral principles. For example, promises should be kept and debts paid, because of one's duty to keep promises and to pay debts, not because of the good or bad results of such actions." (Buchholtz, 1995, p.475). The basis for the duty can be based on religion, justice, rights or reason. Rawls (1971) argued that within any society, there are several equal liberties (for example, access to education and justice, equality of opportunity) which are similar for all. Justice is often expressed in terms of fairness or what is deserved. A person has been treated justly when he or she has been given what is due or owed that person, what he or she deserves or can legitimately claim. The so-called formal principle of justice states that like cases should be treated alike - equals ought to be treated the same and unequals unequally. Weiss (1998) argues that the moral basis for rights is entitlement viewed from an individual and not a societal or group point of view. Individual freedom, welfare, safety, health and happiness are essential core values of moral rights.

According to Kant's theory of ethical formalism, or principle of the categorical imperative (in Buchholtz, 1995; Weiss, 1998), as 'reason' is assumed to be the same for all people, what is rational and moral is the same for all people. The categorical imperative consists of two parts. Kant insisted that a person's reasons for acting must be reasons that he or she would be willing to have all other persons use as a basis for how they would treat him or her. The second states that in an ethical dilemma, a person should act in a way that respects and treats all others involved as ends, as well as means to an end. An action is morally right if and only if the action respects people's capacity to choose freely for themselves (Buchholtz, 1995, p.477)

Some of the difficulties with these theories for corporate decision makers are that there are often competing duties and obligations. It is not practical to use the impact on all humanity as a basis for decision making. Nor do the theories give guidance for prioritising between conflicting responsibilities. Should governments for example, tie their trade or aid to developing nations to policies that promote western concepts of democracy, human rights, freedom of expression or environmental control. Should a multinational pursue a practice in a foreign country that is banned in its home environment? Within an organisation, how does one balance shareholder and other competing rights?

All the classical management theories cast the manager in a corporation as a rational actor motivated by servicing the interests of owners. Leaders were seen as making either/or choices. Relationships based on power and conflict determined the political activity within an organisation and between the organisation and its external stakeholders. Situational constraints determined their freedom to apply their own

ethical principles in making moral judgements, and taking action. McKenna (1999) suggests that this is essentially a masculine epistemology emphasising power and conflict. It creates a paradox for a manager, whether to be loyal to a dominant political coalition, usually the owner, or to apply ethical principles in response to the needs of other groups of stakeholders, both internal and external.

Recognition of additional stakeholders within the environment, and inside the business domain, requires that managers encompass a wider range of participants in their decision making. This has led to the development of a stakeholder approach to business ethics which is an analytical way of observing and explaining how different constituencies are affected by and affect business decisions and actions. Ethical reasoning in a stakeholder analysis (Weiss, 1998) means asking: What is equitable, just, fair and good for those who affect and are affected by business decisions? Who are the weaker stakeholders in terms of power and influence? Who can, who will, and who should help weaker stakeholders make their voices heard and encourage their participation in decision processes and outcomes? How does a corporation define and fulfil their ethical obligations to affected constituencies?

Unlike previous theories with their developments of immutable rules and standards, McKenna (1999) describes this as a postmodern approach in which moral dissensus is accepted and moral debate occurs. The aim is to have moral sensitivity for the practical and other implications of one's moral persuasion, and to accept that two or more valid rival positions could exist, and that rival parties in the dialogue would be willing to reformulate their own positions. Stakeholder analysis simplifies the ethical dilemmas of managers in an organisational context because: it is based on a feminine rather than a masculine metaphor (relationships, adapting to continuous change, communication, collective action); it is based on an epistemology of community conversations; and it recognises the relevance of stakeholder voice mechanisms. Most importantly, it provides a moral basis for dialogue regarding corporate social responsibility. Its weakness is that, too often, facts are interpreted according to a current world view, which may change over time and culture.

Future research into Ethical Corporate Leadership

Little empirical work has been done on the relationships between leadership models, ethical decisions and commitment to corporate social responsibility, the ethical consequences of the trade offs between stakeholders implied in the stakeholder model of corporate social responsibility, or the consequences of cross cultural differences in stakeholders. Furthermore, the effects on the motivation of corporate leaders from seeking the achievement of higher order ethical goals is unresolved. These issues represent emerging challenges for future research.

Conclusion

The conclusion from the argument in this paper is that corporations have a corporate social responsibility and that because of it corporate leaders are motivated to act responsibly and make ethical decisions in the interests of society.

Traditional ethical theories appear to offer inadequate guidelines for leaders operating in complex environments and facing complex problems. A postmodern approach to

ethics based on stakeholder theory and ethical reasoning requires that, when making decisions, corporate leaders take into account different constituencies and how they are affected. If they are to provide the ethical leadership required to build ethical organisations, they need to be able to draw upon appropriate theories of ethical leadership. The new challenge for researchers is to develop leadership models that integrate the moral imperatives of the stakeholder approach to corporate governance and explain how and why corporate leaders can, and should, support corporate social responsibility in their corporations.

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