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TOWARDS CORPORATE SUSTAINABILITY: THE LINK BETWEEN BUSINESS ETHICS, CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

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Abstract: The root of this study is mostly grounded to an old dilemma between the corporations and the society. The important issue is that, solving this problem requires that, managers should understand the critical factors such as business ethics, corporate governance, and corporate social responsibility and creates solutions by using the outcomes. The aim of this paper is to reframe the discussion and find a link between business ethics, corporate governance and corporate social responsibility for a sustainable business.

Keywords: Business Ethics, Corporate Social Responsibility, Corporate Governance, Corporate Sustainability

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Özet: İş ahlakı, günümüzde işletmeler ve toplum arasındaki ilişkiler arttıkça ve genellikle toplum açısından problem yaratan uygulamalar görülmeye başladıkça daha sıklıkla gündeme gelmeye başlamıştır. Bu çalışmanın temeli, işletmeler ve toplum arasında uzun süredir devam eden bu ikileme dayanmaktadır. Bu sorunun çözümünde, yöneticilerin bu ikilemi yaratan iş ahlakı, kurumsal yönetim ve kurumsal sosyal sorumluluk gibi faktörleri anlamaları ve buna uygun davranışlar sergilemeleri kritik öneme sahip olmaktadır. Bu kapsamda çalışmada, işletme ve toplum arasında süregelen bu sorunların çözümünde yöneticilerin tutumlarını yönlendiren iş ahlakı kavramı, kurumsal yönetim ve kurumsal sosyal sorumluluk kavramları ile ilişkilendirilerek, işletmenin uzun vadede sürdürülebilirliğini sağlama perspektifi ile değerlendirilecektir.

Anahtar Kelimeler: İş Ahlakı, Kurumsal Sosyal Sorumluluk, Kurumsal Yönetim, Kurumsal Sürdürülebilirlik

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1. Introduction

Whenever managers need to make a decision, they face a problem: what is the right thing to do? Most of the time, choosing the right decision is a matter of business judgment. Choosing the legal one is an option, but in some cases neither the law nor the business judgment may be clear enough to show the way. These decisions often involve conflicting issues of what is right in a moral sense. Shortly, decision-making is a matter of ethics.

How should managers determine what is the right decision? Is shareholder value more important than corporate social responsibility when crucial decisions are made? Managers face serious pressure to do the “good” thing when they try to make the “right” choice. The ethical direction and sustainability of corporation is the result of ethical actions of the managers. This statement has never seemed more true than when unethical and illegal decisions by Enron managers brought down Enron and destroyed the financial security of its employees and many shareholders. Enron, WorldCom and many other famous bankruptcies typically show the potential impact of unethical, as well as illegal business practices on companies, employees, investors, and society. In addition, many other corporate scandals from all over the world, especially such from the reliable economies like Germany and UK, have put business ethics, and in addition corporate governance, high on the list of the business world.

Since managers are the link between the company, owners, shareholders and stakeholders; their ethical or unethical behaviors are critically important. However, business scandals have had little impact on the ethical behavior of managers, even though the ethical sensitivity and the development of ethical codes of behavior often increase after business scandals.

Managers in the corporations should always strive for ethical behavior. It may not be easy to act in an ethical way or there may not always be a single correct answer to any ethical dilemma. People may state many reasons for wanting to be ethical. These statements may include an inner benefit, personal advantage, peer approval, religion and habit. However, there might be some obstacles that people face when trying to be ethical, such as self interest and the search for happiness. In an American Management Association and Human Resource Institute (AMA/HRI) 2005 survey, managers were asked to rank the reasons to make sure their companies operate in an ethical manner are: They are protecting the brand and reputation; It is the right thing to do; It is used to establish customer trust and loyalty; It increases the level of investor confidence; It helps in developing public acceptance and recognition.¹

It was also interesting to note the role ethics play in the operations of business. In the same survey of AMA/HRI (2005), the top five ranked reasons that drive business ethics are: Corporate scandals; Marketplace competition; Demands by investors; Pressure from customers; and Globalization.² As a result of AMA/HRI survey, it is easy to say that stakeholders have a significant role in shaping the ethical position of the corporation.

¹ Peter A. STANWICK, Sarah D. STANWICK, *Understanding Business Ethics*, New Jersey: Pearson Education, 2009, p. 29.

² Peter A. STANWICK, Sarah D. STANWICK, *op. cit.*, p. 30.

A fundamental truth is that business cannot exist without society, and society cannot go forward without business. Thus, business must acknowledge society's existence and society's growing demand for more ethically responsible business practice. Business ethics, corporate governance and corporate social responsibility are the most frequently used business concepts today. Indeed, it is not easy to think of them individually, without building a connection with the others. Which means that they have a complementary effect. The main reason underlying this popularity is the changing role of the corporations in society, in other words, the ruining of the sensitive balance between the corporation and the society, or the degeneration of the corporate practices and the erosion of the personal values. The corruption between the corporation and the society has created a dramatic change of the stakeholders to the corporations and thus create a significant effect on the sustainability of the corporations.

As a result of this corruption and degeneration as mentioned above, many of the corporations have lost their wealth or some of them have collapsed. This situation has also some deep impacts on society. Besides, the suffering of the social sources must be considered. With the mission to create some benefits to the society and be a good corporate citizen, corporations are under the lash of criticism and their practices are deeply questioned by stakeholders. From this dilemma between the corporations and the society, this study tries to find a link between business ethics, corporate governance and corporate social responsibility for a sustainable business.

2. The Fundamental Problem of the Business: Being (Un)Ethical?

Ethics can be defined as the values an individual uses to interpret whether any action or behavior is considered acceptable and appropriate. On the other side, business ethics is the collective values of a business organization that can be used to evaluate whether the behavior of the collective members of the organization are considered acceptable and appropriate.³

Business ethics is currently a very popular business issue. Many debates and dilemmas around business ethics have attracted the attention of various parties. Especially, the integration of corporations into the society has made business ethics more important than ever.⁴ Simply, consumers, governments and pressure groups appear to be demanding that corporations should find more ethical and ecologically safer ways of doing business and respect to society. The media also constantly keeps the track of corporate misconducts or malpractices and show them to public. This brings business ethics into a new evaluation process from "sustainability perspective" by integration the responsibilities of the corporations.⁵

Today, many of the philosophers are questioning the nature of capitalism and the impact of global companies on environment and society and trying to find solutions by conducting international forums. On the other end, some of the corporations, begin to realize their potential effects on the society and try to improve their ethical

³ Peter A. STANWICK, Sarah D. STANWICK, op. cit., p. 2.

⁴ Andrew CRANE, Dirk MATTEN, Jeremy MOON, *Corporations and Citizenship*, New York: Cambridge University Press, 2008, p. 18.

⁵ Denis COLLINS, *Essentials of Business Ethics: Creating an Organization of High Integrity and Superior Performance*, New Jersey: John Wiley and Sons, 2009, p. 234.

conduct in order to survive. Also, corporate managers understand that they need to live in peace with the society and protect what is valuable for human beings.⁶

According to Friedman, there is a purely economic argument that corporations act responsibly when they fulfill their duty and legal obligations to shareholders to maximize profits.⁷ Today, economic contribution of corporations to the society is not considered to be enough. Society is expecting many other responsibilities from the corporations.⁸ The influence and power of corporations in society is greater than ever before. Many members of the public feel uncomfortable with this effect. Globalization also has a doubling effect on these developments. Environmental pollution, child labor, restricted social right of workers, inappropriate working condition, and discrimination are just a short list of the effects of global corporations. There is no doubt that globalization is a demanding arena for corporations to define and legitimize their ethical behavior.⁹

The unethical behavior of the corporations' has the potential to inflict damage on society, and on the environment. At this point, it is possible to think about the law. It is true that the law is about the issues of right and wrong. The law is the codification of ethics into specific social rules, regulations, and proscriptions.¹⁰ The law might be said to be a definition of the minimum acceptable standards of behavior. Business ethics can be said to begin where the law ends.¹¹

Stakeholders demand that corporations should seek more ethical ways of doing business. These demands might be very complex most of the time and more challenging. It is possible to see the social discomfort in many of the global organizations with the help of protesters by challenging the nature of capitalism and questioning the impact of global corporations in society. As a result, every decision taken by the corporations have the potential to create harm on the society, and on the environment in which they live thus creating negative impact on continuity of the business.

Based on those ideas, the focus of this paper will be to analyze and discuss the relationships between business ethics, corporate social responsibility and corporate governance; adopting a stakeholder perspective to create a sustainable organization.

3. Sustainability: A New Search for Business

Sustainability is a key term both for business and society. For a business to be sustainable is to live in its own environment with its stakeholders in peace for a long

⁶ Arie De GEUS, *The Living Company: Habits for Survival in a Turbulent Business Environment*, Boston: Harvard Business School Press, 2002, p. 22.

⁷ Milton FRIEDMAN, "The Social Responsibility of Business is to Increase Its Profits", *New York Times*, (September 13, 1970) in: Walther Ch. ZIMMERLI, Klaus RICHTIGER, Markus HOLZINGER (Eds.), *Corporate Ethics and Corporate Governance*, Berlin: Springer-Verlag, 2007, p. 173.

⁸ Rogene A. BUCHHOLZ, "Corporate Responsibility and The Good Society: From Economics to Ecology", *Business Horizons*, (July-August 1991), p. 21.

⁹ Andrew CRANE, Dirk MATTEN, *Business Ethics*, Oxford: Oxford University Press, 2004, p. 14.

¹⁰ Manuel G. VELASQUEZ, *Business Ethics*, 6h. Ed., New Jersey: Pearson Prentice Hall, 2006, p. 37.

¹¹ Linda K. TREVINO, Katherine A. NELSON, *Managing Business Ethics: Straight Talk about How to Do It Right*, 3 rd. Ed., New Jersey: John Wiley & Sons, 2004, p. 16.

time.¹² For a society to be sustainable is to use its resources effectively and efficiently so the next generations can live. Business and society live together, both are dependent to each other.¹³ In an economical saying, they both use their outputs and generate input for each other, which means that they are interdependent. Environmental pollution caused by production and use of products like cars, refrigerators; pollution caused by waste disposal; social effects of plant closures and inappropriate working conditions and many more have erosive effects on society.

Sustainability has also become an increasingly common term in business ethics and has been widely used by corporations, governments, pressure groups and academics. The goals and consequences of business have been widely discussed in Summits like “Rio Earth Summit” of 1992. As a widely promoted concept about sustainability is that, it is not meaningful to assess business activities specifically, but industrial and social development more generally. According to the ethical argument, the corporations are morally obliged to give back to the society in which they live.¹⁴ This responsibility arises for at least two reasons. Firstly, corporations are obliged to make a payment in kind for using society’s resources to generate profit. Secondly, corporations have a duty to reimburse society for the negative side effects their activities generate. The moral obligation is greater than that on individuals because of the powerful role corporations play in society. Many of the large corporations own more financial capital than governments, and they are the most powerful economic force in society today. In the ethical argument, the corporations’ moral obligations to society must be considered in all decisions.¹⁵

For a long time sustainability, as a concept, was synonymous with environmental sustainability. More recently, the concept of sustainability has been broadened to include not only environmental considerations, but also economic and social considerations. This extension of the sustainability arose primarily because it is sometimes impossible to define the sustainability of natural environment, without also considering the social and economic aspects of relevant parties and their activities.¹⁶

¹² Arie De GEUS, *op. cit.*, p. 172.

¹³ Linda K. TREVINO, Katherine A. NELSON, *op. cit.*, p. 6.

¹⁴ David E. HAWKINS, *Corporate Social Responsibility: Balancing Tomorrow’s Sustainability with Today’s Profitability*, New York: Palgrave MacMillan, 2006, p. 62.

¹⁵ Kerstin SAHLIN-ANDERSON, “Corporate Social Responsibility: A Trend and a Movement, but of What and for What?”, *Corporate Governance*, Vol. 6, No. 5, 2006, p. 596.

¹⁶ John ELKINGTON, *Cannibals With Forks: The Triple Bottom Line of 21st Century Business*, Oxford: Capstone Publishing, 1997, p. 72.

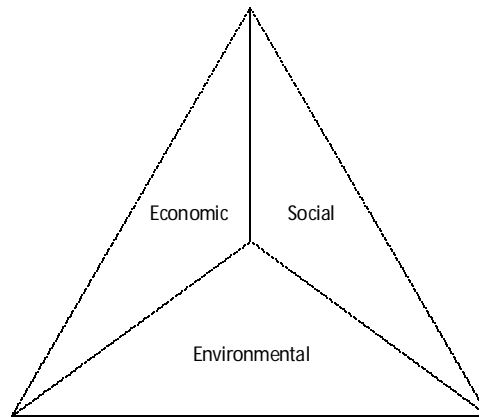


Figure 1: John ELKINGTON, *Cannibals With Forks: The Triple Bottom Line of 21st Century Business*, Oxford: Capstone Publishing, 1997, p. 72.

As a result, sustainability can be regarded as comprising three components, which is called as “Triple Bottom Line” by Elkington (1997); environmental, economic, and social (Figure 1). From his perspective, Triple Bottom Line represents the idea that business does not have just one single goal, which is adding economic value, but it has an extended goal set which consists of adding environmental and social value too.¹⁷

From the above explanations, it is clear that sustainability is a potentially important goal for business ethics. Issues of an ethical nature, demand that we consider a diverse and complex range of considerations.

4. Corporate Social Responsibility

Ethical behavior and socially responsible practices in business have been extensively discussed since 1980's (e.g., Drucker, 1984; Carroll, 1993; Wicks, et.al, 2010) and have accepted as one of the most important aspects of management practices and decision-making process. An appreciation of the role of ethics and social responsibility as components of business decisions affecting organizational effectiveness is essential.¹⁸

According to Davis, social responsibility is the obligation of decision makers to take actions which protect and improve the welfare of society as a whole along with their own interests. This definition suggests two active aspects of social responsibility—protecting and improving. To protect the welfare of society implies the avoidance of negative impacts on society. To improve the welfare of society implies the creation of positive benefits for society.¹⁹ The concerns included within CSR are as follows:

¹⁷ John ELKINGTON, op. cit., p. 70.

¹⁸ Anusorn SINGHAPAKDI, et. al., “The Perceived Role of Ethics and Social Responsibility: A Scale Development”, *Journal of Business Ethics*, Vol. 15, No. 11, 1996, p. 1132.

¹⁹ Keith DAVIS, “The Case for and Against Business Assumption of Social Responsibilities”, *Academy of Management Journal*, Vol. 16, No. 2, (June 1973), p.313.

Corporate Governance, relating to top-level decision-making, accountability, risk management and the remuneration of executives; environmental management and the concept of sustainability; treating employees fairly; operating ethically in the marketplace, in terms of suppliers and customers; ethical investment and social reporting.²⁰

Corporate social responsibility is seriously considering the impact of the company's actions on society. Corporate social responsibility requires the company to consider its acts in terms of a whole social system, and holds it responsible for the effects of its acts anywhere in that system. According to Carroll, the systematic reasoning for corporate social responsibility (CSR) started in the USA in the 1950's. During this time many different debates have been argued about CSR. Those debates can be summarized in two categories:²¹

1. Why do the corporations might have social responsibilities as well as financial responsibilities?
2. What is the nature of these social responsibilities?

The first question has had many controversies in the past, but now it is widely accepted by many industries that corporations do have economic, social and environmental responsibilities. Davis has outlined the arguments for and against corporate social responsibility.²² Many of the arguments suggest that corporations take social responsibilities for its own self-interest. Corporations perceived that are socially responsible might be rewarded with extra customers, while perceived irresponsible may result in the decrease in sales or result some customer boycotts. In some cases, employees might be attracted to work for corporations perceived as being socially responsible. Even government might be interested in socially responsible actions of corporations and show some convenience in terms of legal issues, such as tax or financing. Those issues might be considered important for a corporation to create continuity in doing business which in turn create a platform for corporations to live.

In addition to these arguments, it is also important to consider some other moral arguments. It is true that corporations create some social problems and because of that they have a responsibility to solve them and to prevent further problems arising.²³ Corporations are powerful social actors; they must use their power and resources responsibly in society. As a stakeholder, corporations are deeply rooted in society and have a duty to take into account the interest and goals of society and create impact, they cannot escape responsibility for those impacts.²⁴

The second question is, if corporations have some social responsibility, what is the nature of that responsibility? The most established and accepted model of corporate social responsibility which defines this question is Carroll's "Four-Part Model of Corporate Social Responsibility". Carroll's definition focuses on the types of social

²⁰ David E. HAWKINS, op. cit., p. 4.

²¹ Archie B. CARROLL, Ann K. BUCHHOLTZ, *Business and Society: Ethics and Stakeholder Management*, 4th. Ed., Cincinnati: South-Western Publications, 2000, p. 27.

²² Keith DAVIS, op. cit., p. 313.

²³ John M. ETHEREDGE, "The Perceived Role of Ethics and Social Responsibility: An Alternative Scale Structure", *Journal of Business Ethics*, Vol. 18, 1999, p. 51.

²⁴ Richard T. De GEORGE, *Business Ethics*, 6th. Ed., New Jersey: Pearson Prentice Hall, 2006, p. 199.

responsibilities that business has. According to Carroll, CSR is a multi-layered concept which consists of economic (be profitable), legal (obey the law), ethical (be ethical) and philanthropic responsibilities (be a good corporate citizen) which are interrelated. He represents these responsibilities as layers of a pyramid (The Pyramid of Corporate Social Responsibility), and concludes that true social responsibility requires the meeting of all four levels consecutively.²⁵

The benefit of Carroll's model is that, it structures the social responsibilities into different dimensions, but it does not seek to explain social responsibility when there is pressure on the corporation to be profitable and legal. In the strategic focus of Corporate Social Responsibility, it is important to consider how corporations actively respond to social problems and expectations. As an example, tobacco companies now admit that they are in a controversial industry, selling risky products. But, some of the companies create different programs for the sake of society such as youth smoking prevention program as corporate social responsiveness.²⁶

4.1. Business Ethics and Corporate Social Responsibility: Can Corporations Have Social Responsibilities?

Is it possible to assign certain types of responsibilities to corporations? Corporations are not like human beings. Before deciding what responsibilities they might have, we need to define what they are and why they exist. Since corporations are the dominant form of business entity in the modern economy, it is expected to act more responsibly.²⁷ For the law, corporations are regarded as artificial persons; they have certain rights and responsibilities in society like individual citizens. Corporations are owned by shareholders, but exist independently of them, that is, shareholders have limited liability for the debts or damages caused by the corporation. Managers have the responsibility to protect the investment of shareholders, that is, they are the agents of the shareholders.²⁸

In 1970, economist Milton Friedman published an article titled "The Social Responsibility of the Business is to increase its Profits" in New York Times Magazine to question the social role of corporations, and he protested against the notion of social responsibilities for corporations. He based his arguments in three ideas:²⁹

1. Only people can have moral responsibility for their actions,
2. The manager is the agent of individuals who own the corporation, therefore it is managers' responsibility to act for the interest of shareholders,
3. Social issues and problems are the business of the state rather than corporate managers.

The debate regarding the assignation of moral responsibility to corporations is a long and complex one, but there is a support from the literature (Davis 1973, Ewin 1991,

²⁵ Archie B. CARROLL, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders", *Business Horizons*, Vol. 34, No. 4, (July-August 1991), p. 42.

²⁶ Andrew CRANE, Dirk MATTEN, op. cit., p. 48.

²⁷ Archie B. CARROLL, Ann K. BUCHHOLTZ, op. cit., p. 18.

²⁸ Martin RICKETTS, *The Economics of Business Enterprise*, Third Ed., Cheltenham: Edward Elgar, 2002, p. 262.

²⁹ Milton FRIEDMAN, op. cit., p. 173.

French 1979, Moore 1999) for some degree of responsibility to be accredited to corporations³⁰. This is, of course not the same form as the moral responsibility of individuals.³¹ According to those debates, in order to assign responsibility to corporations, in addition to the legal independence from their members, corporations also have agency independent of their members.³²

According to Ewin (1991), there are two main arguments that support this debate. The first argument looks at the fact from decision making point of view. Apart from individuals taking decisions in the companies, every company has an internal corporate decision structure that guides the organization to its predetermined goals. This internal decision structure, results that, majority of corporate actions cannot be assigned to any individual's decisions or responsibilities alone.³³ This view does not exclude that the fact that individuals still act independently in the corporation and that there are some decisions that can be directly associated with individuals. This view also points out that, corporations normally have a framework of decision making that is beyond individual's framework of responsibility. The second argument, also supporting the first one, is the fact that companies not only have a corporate internal decision structure, but also have a set of beliefs and values that shows what is right and what is wrong in the organization – namely the “organizational culture”. These values and beliefs are widely believed to be a strong influence on the individual's ethical decision-making and behavior. Hence, many of the issues for which corporations receive either praise or blame can be traced back to organizational culture of the company.³⁴

As a conclusion of those debates, corporations have some moral responsibilities which is more than the responsibility of the individuals constituting the corporation. Therefore, not only the legal framework of the countries treat the corporation as a legal person, which has legal responsibilities, because the corporation also appears to have moral agency which shapes the decisions made by those in the corporations.³⁵

5. Corporate Governance: Why Stakeholders Matter?

Corporate governance can be defined as the system that is used by corporations to control and direct their operations and operations of the agencies. The corporate governance structure ensures that the corporation satisfies the needs of all stakeholders are satisfied.³⁶ Corporate governance is a very hot topic of all major economies in recent years. This is due to the effect of various national and international corporate scandals. The examples of corporate misconduct in many of

³⁰ R.E. EWIN, “The Moral Status of the Corporation”, *Journal of Business Ethics*, Vol. 10, 1991, p. 749.

³¹ Peter A. FRENCH, “The Corporation as a Moral Person”, *American Philosophical Quarterly*, Vol. 16, No. 3, (July 1979), p. 207.

³² Geoff MOORE, “Corporate Moral Agency: Review and Implications”, *Journal of Business Ethics*, Vol. 21, No. 4, 1999, p. 332.

³³ R.E. EWIN, *op. cit.*, p. 749.

³⁴ Amanda SINCLAIR, “Approaches to Organisational Culture and Ethics”, *Journal of Business Ethics*, No. 12, 1993, p. 65.

³⁵ Geoff MOORE, *op. cit.*, p. 330.

³⁶ Peter A. STANWICK, Sarah D. STANWICK, *op. cit.*, p. 60.

the largest corporations of the world generated a very high interest in the ethical dimensions of corporate governance.³⁷ According to Shleifer and Vishny (1997)³⁸ “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do suppliers of finance control managers?” . This broader view of responsibility gives new roles to management. Management is not only the agent of shareholders, besides management has to take into account the interests and rights of all stakeholders.³⁹ Managers still have a responsibility against shareholders; they must balance this with the conflicting interest of other stakeholders for the sustainability of the corporation.⁴⁰ Since the company is responsible from their actions and effects other stakeholders and society, and also obliged to respect the rights of all stakeholders, this might also mean that, stakeholders should be able to take part in the managerial decisions which will affect their rights. This creates the basis for corporate governance, which regulates the rights of the stakeholders.

The stakeholder theory is the most popular and influential theory to emerge from business ethics and corporate governance. Unlike the Corporate Social Responsibility, which focuses on the corporation and its responsibilities, the stakeholder approach focuses on various groups to which the corporation has a responsibility. The main approach in stakeholder theory is that, the corporations are not managed in the interests or their shareholders. There are also stakeholders that have legitimate interest in the corporation as well. According to Freeman, a stakeholder is an organization, any group or individual who can affect, or is affected by the achievement of the organization's objectives.⁴¹ Or in a broader way, a stakeholder of a corporation is an individual, group or other institutions which either is harmed by, or benefits from the corporation; or whose rights can be violated, or have to be respected by the corporation. This view of the stakeholder, contains both corporate rights (do not violate the right of others) and corporate effects (corporations are responsible from their actions) such as corporate social responsibilities.⁴²

Corporate governance has specified the rules of business decision making that apply to the internal mechanisms of companies. These norms and laws has shape the relations among boards of directors, shareholders, and managers as well as to resolve agency conflicts.⁴³

³⁷ Andrew CRANE, Dirk MATTEN, op. cit., p. 190.

³⁸ Andrei SHLEIFER, Robert W. VISHNY, “A Survey of Corporate Governance”, *The Journal of Finance*, Vol. 52, No. 2, (June 1997), p. 737.

³⁹ Andrew CRANE, Dirk MATTEN, Jeremy MOON, op. cit., p. 100.

⁴⁰ R. Edward FREEMAN, *Strategic Management: A Stakeholder Approach*, Boston: Pitman, 1984, p. 80.

⁴¹ R. Edward FREEMAN, op. cit., p. 46.

⁴² Neil A. SHANKMAN, “Reframing the Debate Between Agency and Stakeholder Theories of the Firm”, *Journal of Business Ethics*, Vol. 19, No. 4, 1999, p. 322.

⁴³ Amiram GILL, “Corporate Governance as Social Responsibility: A Research Agenda”, *Berkeley Journal of International Law*, Vol. 26, No. 2, 2008, p. 453.

5.1. Understanding Corporate Governance: The Importance of Shareholders as Stakeholders

After the industrial revolution, corporations were both owned and managed by their owners, in other words, owners both execute their owner and manager roles at the same time. The separation of ownership and management functions is the most important aspect of today's corporations. The separation of ownership and control is the center of corporate governance. Corporate governance must be concerned with the processes by which organizations are directed, controlled and held accountable in order to secure the economic sustainability as well as the legitimacy of the corporation.⁴⁴ This way, corporate governance can be understood as a process by which corporations are made responsive to the rights and wishes of multiple stakeholders.

The debate about this separation began on the 1930s, after the Great Depression.⁴⁵ Managers have the responsibility to run the company in the interest of shareholders. They have the duty to act for the benefit of the company, the duty of care and the duty of diligence.⁴⁶ As a result, we can say that the main duty of the manager is to manage the property of shareholders. But the conflict between the rights of the shareholders and the duties of the managers create the corporate governance problem which in turn create corporate scandals. The Enron and other corporate scandals, whose executives were charged with fraud and theft, focused attention on corporate governance. These scandals were about the corruption at the top.⁴⁷

There are also some conflict of interest between managers and shareholders. While shareholders want profit and rise in share price; managers want to have high salaries and power. There is also an informational asymmetry between the shareholders and the managers. Managers have more knowledge than the shareholders about the company and the markets. This also yields to the problem of managers' conflict of interest with the shareholders. Divergent interests and unequal distribution of information between shareholders and managers create some fundamental ethical conflicts in governance as the result of the agency problem.⁴⁸ This agency relation problem can create ethical problems and dilemmas for both side in the context of corporate governance.

While literature on corporate governance has focused primarily on the rights of shareholders, stakeholder theory takes a broader view. Corporate governance and stakeholders are central issues in contemporary debates in business ethics.⁴⁹ Stakeholders include all that are affected by, or can affect, the firm's activities, including not just managers, shareholders and employees, but also representatives of the broader community as well. Understanding these concepts and the current debates around them should enhance our understanding of the ethical challenges facing businesses nowadays.

⁴⁴ Christine A. MALLIN, *Corporate Governance*, Oxford: Oxford University Press, 2004, p. 11.

⁴⁵ Andrew CRANE, Dirk MATTEN, *op. cit.*, p. 186.

⁴⁶ Martin RICKETTS, *op. cit.*, p. 270.

⁴⁷ Richard T. De GEORGE, *op. cit.*, p. 214.

⁴⁸ Christine A. MALLIN, *op. cit.*, p. 11.

⁴⁹ Kamel MELLAHI, Geoffrey WOOD, *The Ethical Business: Challenges and Controversies*, N.Y.: Palgrave MacMillan, 2003, p. 21.

Stakeholder theory contrasts Friedman's (1970) traditional view which asserts that the primary function of the firm is to maximize the return on investments to the owners of the business, that is, the shareholders. According to the stakeholder theory, the firm needs to consider the interests of 'all' groups affected by the firm. Stakeholder theory is an important and commonly used framework for business ethics. Freeman (1984) asserts that stakeholder theory is a promising framework for business ethics because it acknowledges a 'plurality of values'.⁵⁰

For the sustainability of the corporation, both executives and shareholders should take their responsibilities to act ethically. There are many research focusing on the responsibilities of the executives, on the other side, shareholders' also have some responsibilities for sustainability. With the rise of the sustainability, many attempts have emerged to construct share indexes that rate corporations' performance towards sustainability.⁵¹ Dow Jones Sustainability Index (DJSI) was the first to focus on companies' sustainability performance. Launched in 1999, the Dow Jones Sustainability Indexes are the first global indexes tracking the financial performance of the leading sustainability-driven companies worldwide.⁵² Also in Europe, there is a growing interest towards sustainability. In 2001 "FTSE4Good Europe" was launched in London in this respect. The FTSE4Good Index Series has been designed to measure the performance of companies that meet globally recognized corporate responsibility standards and to facilitate investment in those companies. This includes a series of indices (such as human rights, stakeholder relations and the environmental impact of company's activities) embracing companies meeting certain social, environmental and ethical standards.⁵³ There are also indexes that measure the price and return performances of listed companies with a corporate governance rating, such as Istanbul Stock Exchange's Corporate Governance Index.⁵⁴ As a result, these improvements show that, investors are interested in financial performance with the broader goal of sustainability.

6. The Role of Management: Linking Business Ethics, Corporate Governance and Corporate Social Responsibility with Management Behavior

Corporate governance suggests that, companies are encouraged to promote ethics, fairness, transparency, and accountability in all their dealings. They are expected to continue generating profits while maintaining the highest standards of governance internally. Corporate decisions should also be aligned with the interests of different players within and outside the corporation. Hence, businesses have to keep their activities attuned to society's ethical, legal, and social aspirations. At this point, business ethics, corporate governance and corporate social responsibility create an intersection. Corporate social responsibility, is about the companies' interactions

⁵⁰ Kamel MELLAHI, Geoffrey WOOD, op. cit., p. 27.

⁵¹ Archie B. CARROLL, Ann K. BUCHHOLTZ, op. cit., p. 55.

⁵² <http://www.sustainability-index.com/>

⁵³ http://www.ftse.com/Indices/FTSE4Good_Index_Series/index.jsp

⁵⁴ <http://www.ise.org/Indexes/StockIndexesHome/CorporateGovernanceIndex.aspx?sfppl=true>

with their various stakeholders – from providing quality products and services, to undertaking charitable activities.⁵⁵

According to Rossouw (2005), corporate governance has an ethical nature. The arrangements and processes in the corporate governance system, such as board compilation and functioning, risk management and auditing, reporting and disclosure requirements, and so on, ensure that the corporation will act as fair, accountable, responsible, and transparent. On the regulatory and enterprise levels, corporate governance is intended to ensure that a balance between the interests of the company and its primary stakeholders is constructed. This ethical foundation of corporate governance gives rise to the hope that corporate governance will restore trust in business.⁵⁶

After the big corporate scandals, corporate governance has shifted from its traditional focus on agency conflicts to address the issues of ethics, accountability, transparency, and disclosure. Besides, corporate social responsibility has focused more on corporate governance as a tool for incorporating social and environmental concerns into the business decision-making process, benefiting not only financial investors but also employees, consumers, and society. Currently, corporate governance is being linked more and more with business practices and public policies that are stakeholder-friendly.⁵⁷

The main task of management is to create a mechanism to control the activity of employees to best serve defined organizational interests. Managers can make this control by using some rules, rewards and discipline systems or using values and norms about how the work is to be done. At this point, manager is the link between shareholders and stakeholders. As Velasquez (1996) concludes, "...justice is more profitable, more rational, and more intrinsically valuable than injustice, even in business. The research on prisoners' dilemmas shows that ethical behavior is more profitable and more rational than unethical behavior in terms of both the negative sanctions on unethical behavior and the positive rewards of ethical behavior; and the psychological research on justice shows that justice is intrinsically valuable, both from an outcome and from a process perspective, and so crucial for business organizations, particularly in terms of organizational effectiveness."⁵⁸ These ethical actions are critically important, because managers link labor, shareholders, suppliers, customers, and society as well. Establishing such a connection could improve understanding of ethical managerial values and could provide a basis for altering managerial behavior. As a result, the ethical actions of managers directly affect the ethical direction and the sustainability of the corporation.⁵⁹

⁵⁵ Dima JAMALI, Asem M. SAFIEDDINE, Myriam RABBATH, "Corporate Governance and Corporate Social Responsibility Synergies and Interrelationships", *Corporate Governance*, Vol. 16, No. 5, (September 2008), p. 444.

⁵⁶ G. J. ROSSOUW, "Business Ethics and Corporate Governance: A Global Survey", *Business & Society*, Vol. 44, No. 1, (March 2005), p. 37.

⁵⁷ Amiram GILL, *op. cit.*, p. 471.

⁵⁸ Manuel VELASQUEZ, "Why Ethics Matters: A Defense of Ethics in Business Organizations", *Business Ethics Quarterly*, Vol. 6, No. 2, 1996, p. 216.

⁵⁹ Shane PREMEAUX, "The Link Between Management Behavior and Ethical Philosophy in the Wake of the Enron Convictions", *Journal of Business Ethics*, Vol. 85, 2009, p. 13.

Corporate governance is the relationship between the corporation and the stakeholders that determines and controls the strategic direction and performance of the corporation. Corporate governance system gives a method in which the ethical vision can be measured and validated. This system governs the behavior of the managers within the corporation. The corporate governance system not only incorporates the objectives of the stakeholders, but also ensures that the behavior of the employees is fair, just and transparent. From the corporate governance perspective, the firms have the ability to interpret their ethical duty to their stakeholders.⁶⁰

On the sustainability side of the corporation, corporate governance defines a set of relationships between a company's management, its board, its shareholders and its stakeholders. It is the process by which directors and auditors manage their responsibilities towards shareholders and wider company stakeholders. For shareholders it can provide increased confidence of an equitable return on their investment. For company stakeholders it can provide an assurance that the company manages its impact on society and the environment in a responsible manner.⁶¹

7. Conclusion

Many of the corporate scandals like Enron, WorldCom and Parmalat caused by greed, political connections, and unethical actions resulted in a bankruptcy that ruined the lives and savings of many employees and shareholders. These types of scandals typically show the potential impact of unethical, as well as illegal, business practices on companies, employees, and investors. These inappropriate actions have create a new ethical awareness on managers and prove that devastating outcomes can result from such unethical behaviors. Because of the unethical, irresponsible and illegal behavior of managers a great deal of attention is once again focused on business ethics.

Some investors care about not only the financial but the social bottom line of business. Those called "socially responsible investors" insist that their investments also meet ethical criteria as well. Socially responsible investing is growing rapidly. There are many funds in the world that use some sort of social screening, and these funds have performed better than other funds. In terms of business ethics, for this type of investors, their interests are no longer away from employee, customer, environment and community interests.⁶² It also indicate that multiple stakeholder view is a necessity for the continuity of a business

Corporate governance is about ensuring that companies take responsibility to direct and control their activities that is fair to their stakeholders. According to Rossouw (2005) there are two important issues about this responsibility. First, this responsibility can either be taken voluntarily by the boards of directors of companies or it can be imposed on them by regulating bodies or by combining these two. Second, the scope of stakeholders toward whom the company should be responsible is a contested issue in corporate governance, as some corporate governance regimes restrict these stakeholders almost exclusively to shareholders, while other corporate

⁶⁰ Peter A. STANWICK, Sarah D. STANWICK, op. cit., p. 60.

⁶¹ Ans KOLK, Jonatan PINKSE, "The Integration of Corporate Governance in Corporate Social Responsibility Disclosures", *Corporate Social Responsibility and Environmental Management Journal*, Vol. 17, 2010, p. 17.

⁶² Linda K. TREVINO, Katherine A. NELSON, op. cit., p. 40.

governance regimes are much more inclusive with regard to stakeholders who fall within the ambit of corporate responsibility.⁶³ Irrespective of how corporate governance defines responsibility and the scope, it still has a different ethical character, reflected in the fact that corporate governance requires companies to take responsibility for their impact on societies and on their stakeholders. Therefore, it is not surprising that the importance of corporate governance coincided with a rise in importance of business ethics.

As corporate governance becomes increasingly driven by ethical norms and the need for accountability, and corporate social responsibility adapts to most business practices, a potential convergence between them occurs. Where there were once two separate sets of mechanisms, one dealing with corporate decision-making and the other with people-friendly business strategies, today a more hybridized body of laws (such as Corporate Governance Rules) and norms are regulating the corporate practices.

The main purpose of this study is to highlight the link between frequently used, but not significantly understood, business concepts like business ethics, corporate governance and corporate social responsibility, and clear the dusts so that corporate managers can easily understand and reflect it to their decision-making process for a sustainable business. The task of management is not only to deal with the various stakeholder groups in an ethical way but also to solve the conflicts of interest that occur between the organization and the stakeholder groups. Implicit in this challenge is the ethical dimension present in practically all business decision making where stakeholders are concerned. Being a good manager and a good role model is not a very easy task to accomplish. It means more than just doing the right things, it also means to help employees do the right things. This requires guidance and inspiring people who are confused with ethical dilemmas. Helping also mean defining grey areas and respecting their concerns. For a manager, the most important thing to remember as a role model is what they do is more important than what they say. The actions speak louder than the words.

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⁶³ G. J. ROSSOUW, op. cit., p. 33.

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