Ethics: Key to Good Corporate Governance

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Boards have to gauge the integrity of the company. They must visit the field operations and conduct meaningful conversations with people at every level eye ball to eye ball. It is in this subtle, nuanced integrity watchdog role that boards can make a real contribution.

- Jack Welch
Former CEO of GEC

A company without ethics is like a body without a soul. One of the main objectives of corporate governance is to build a sound ethical foundation for the company at all levels of the corporate hierarchy. Excerpts from a speech by the author.

Key Perspectives

Education for Good Governance; Lessons of Enron and Satyam Scams; From Compliance to Commitment.

Education for Good Governance

1. In post Satyam scenario, it is evident that the governance in order to be a tool to burst the financial bubbles has to rest on and relate to ethics. Inculcating ethics needs imbibing ethics into systems and practices that corporate follow. This would necessarily involve a blood transfusion and, blood transfusion doesn't take place over night. It takes place over decades, if not generations. The emphasis on the Government should, therefore, be to introduce and encourage education, and for that purpose, a structured curriculum on corporate governance- right from the primary school to the level of the graduation; the post graduation; and professional level. The curriculum should be staggered in a manner that when a student is in a primary school, he is taught more on the moral values. When he moves to the middle class, he is exposed to advanced level of moral values and possible role models. In college he should learn more about business ethics. As a professional student, he should learn how to apply ethics to business situations. It is possibly only then that corporate governance in India and the world-over can become an efficient tool to burst the financial bubbles. In fact, this would facilitate a governance system that would not allow any financial bubbles to take place in the first instance.

2. The Government of India should soon take suitable initiative so that such a curriculum is started in a staggered manner - from primary school up to professional curriculum, and in the post employment scenario as a training to the professional managers. In recent times, institutes which are based on teachings of noble souls, like Sri Aurobindo, Sri Ramakrishna, Swami Vivekananda, and for that matter epics like the Ramayana, the Gita, are actively pursuing research, and disseminating knowledge as to how principles of moral/ethics propounded by these noble souls, or, enshrined in these holy books can be applied to business situations.

For a true practitioner of good governance, the goodness has to come from his inner consciousness, and, unless inner consciousness is integral to goodness, good governance would never come. The measures taken would then tend to be superficial or peripheral in nature having demonstrative effect i.e. more of how a company would like to show others rather than how it would like to act and to implement within. Therefore, to that extent ITS and like institutions should introduce subject of ethics/morals based corporate governance in the curriculum for management students.

3. It is a challenge but a few institutions have already taken lead - for example, some of the management institutions have instituted a chair for studying the teachings of laurels, like Sri Aurobindo, Swami Vivekananda, building oriental knowledge and experience, in the context of modern day corporate governance, and disseminating that throughout the country. Sri Aurobindo Society based at Pondicherry is taking and disseminating knowledge on integral management in the students at school and college level, and in the corporate managers in various parts of the country. It is necessary that students and managers at all levels are sensitized on importance of ethics in governance, and made to realise that without ethics a company is like a body without a soul. If through collective efforts the students and managers are sensitized even by 10%, the quality of governance in corporate of today and tomorrow would improve significantly.

The Lessons of Enron and Satyam Scams

4. Rise and fall of the Enron is a classical case study. It was biggest corporate collapse in the recent years caused by failure of corporate governance. A majority of CEO and CFO of top 100 US based MNCs in a survey carried out post-Enron expressed their vulnerability to compromise with business ethics in case they are faced with deteriorating performance and financial health. Back in India, Satyam had a promoter-cum-CEO with a highly proven track record (building up Satyam a worldwide brand). Seemingly, a simple man, and a philanthropist, who would publicly advocate business ethics / morals value system and would empathize with the sufferings of the poor allegedly turned out to be a perpetrator of a fraud. What happened and what we saw was collapse of the one of the best organization, which earned one after another awards for the best corporate governance in India, and internationally. CEO and CFO of that company were conferred awards of the best CEO and CFO respectively from many institutions. Obviously, the world at large was made to believe that the company had sound corporate governance system. The reality, in retrospect, was that the soul of the system i.e. ethics was missing.

5. What has happened after Enron and after Satyam? Are we really sensitized or in any manner better off? Have we identified the root cause behind the malaise? Have we really addressed problems in enabling and ensuring good governance in Indian corporate? Nothing significant has changed excepting of course, demonstration of ability of the government to act swiftly and effectively. Post-Enron, for that matter in post-Satyam or post any other scam, what really happened, ironically was that a long debate that took place in press, media, parliament, international forums. Number of committees and sub-committees were set up by the governments, regulators, trade and industries associations and professional bodies heightening the expectations. Some changes took place in the laws, in the Companies' Act, in the rules and regulations, listing requirements, and, new corporate governance framework was put into place. Significant changes in substance are yet to be evidenced. We had the financial crisis more than a year and a half ago. More than 120 banks in the USA were liquidated. The Lehman brother collapsed. Many of the large corporate were merged or amalgamated. We have not learnt the lesson so far.

6. Post-Enron, the Sarbanes Oxley was enacted. But has that really led to the worthwhile change - possibly not. Companies those practiced the Sarbanes Oxley had to introduce a large number of internal checks and control requirements in their organization. A large number of changes took place in the structure of governance, but nothing came out in substance. We in India crib about the bureaucratic system that we have. Post Sarbanes-Oxley, many of the MNCs were turned into the largest bureaucracies in the world. More and more companies in U.S. are opting for delisting just to save themselves from the burdensome compliances and excessive cost under Sarbanes-Oxley. Listed companies are required to comply with the listing requirements, and are required to make voluminous disclosures. To avoid these companies preferred to delist themselves. What has happened in India in post Satyam scenario? Raju and auditors were arrested and they are in jail and may continue to languish in jail but effectively nothing has changed.

7. Every new generation heralds the changes. And when you prepare your new generation through imparting virtues of good governance at school and college level, then edifies on which structure of corporate governance can be built would be strong. We saw the failure all across U.S.A all across European India in Japan and everywhere. Human nature is the same everywhere.

The failure is not confined to US - The only good thing that happened that earlier people used to crib about countries like India or the Asian countries that they are not well governed - but when it happened in the US people said failure does not necessarily have relevance to level of economic development of the country. Corporate scams in the last year and the recent financial crisis have proved that the governance failure can occur in a best governed economy or best governed government or the best governed company. Further the governance failures can be triggered or caused by scams at any level. Recent example of WIPRO where a middle level executive in the finance functions was instrumental in a serious fraud. Good corporate governance would, therefore, necessarily mean that good governance at all levels. Being in the top management is not necessarily mean that the governance process starts and stops there, or, being in top management, per-se, ensures honest or ethical behaviour or, problems or ethics mainly lies at the lower levels.

It is also important to realise what disconnect between the board and rest of organization. Sitting in the Board, the directors emphasize on significance of good governance, ethics and values. But when they are off the Board back to executive position, they believe and stress on the results even if that means big compromise with the ethics and values. Often the message to the rest of the organization is that we want results and results only. It was ironical that Chairman of the Lehman Brothers admitted that he was not aware of the malice that was so deep rooted in the organization and that led to the collapse of one of the largest and highly regarded investment banker world-wide. This means that the pulse of the organization was not known to the Board. Another example and Indian one - the Chairman of SATYAM said that no one in the organization was aware of the fraud that he was perpetrating for so long. This also puts a serious question on the role of independent directors. They were saying that they were 'blissfully' ignorant of what was happening in the governance of SATYAM. Sitting at the Board level they were not aware of the bare facts which are apparent from the financial statements.

The brief letter of Mr. Raju to the Board Members of SATYAM could be a subject matter of research in as much as that every sentence and word therein communicates a lot more about the organization and its governance system. If the directors are not aware of what they are expected to know or for that matter, if independent directors do not make effort to know what they are expected to, then that means a serious failure at the Board level. Position of independent director and for that matter, every director is a position of trust.

From Compliance to Commitment

The legal frame work at best can become a compelling reason for a company to comply the law on corporate governance. The systems and the processes designed by a professional can define and provide for the boundaries and 'dos and don'ts' within that. However, this is not enough if the corporate are to be well-governed. A highly robust and a delightful building structure can be a good house but not necessarily a good home. Similarly, good governance would necessitate a sense of commitment at all levels to the virtues of ethics, morals and values. Unless the top management walks the talk, good corporate governance might remain an illusion in reality.

Note: The Sarbanes-Oxley Act of 2002 (Pub.L.107-204, 116 Stat.745, enacted July 30, 2002), also known as the 'Public Company Accounting Reform and Investor Protection Act' (in the Senate) and 'Corporate and Auditing Accountability and Responsibility Act' (in the House) and commonly called Sarbanes-Oxley, Sarbox or SOX, is a United States federal law enacted on July 30, 2002, which set new or enhanced standards for all U.S. public company boards, management and public accounting firms. It is named after sponsors U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley (R-OH).

The bill was enacted as a reaction to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems and WorldCom. These scandals, which cost investors billions of dollars when the share prices of affected companies collapsed, shook public confidence in the nation's securities markets.

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