

Corporate Governance and Corporate Social Responsibility

The paradigm of management evolution

Dr. Munira Habibullah
Dr Manisha Panwala

Faculty: Department of Business and Industrial management
Veer Narmad South Gujarat University

Abstract:

The paper attempts to trace the development of corporate governance as an extension of management thought. This is studied from a historical perspective to see how the different corporate governance system has emerged in the context of historical background, technology and political as well as economic structure. The corporate social responsibility as included in corporate governance has emerged as the societal need. As corporate play a pivotal role in influencing the shape of society. The broader perspective of sustainable development integrating the corporate governance, corporate social responsibility and social environment is emerging as an international level. The major difference in the Anglo-American, European system of corporate governance, Japanese and German system are to be understood in this context. The paper first explains the evolution of management thought and then studies the emergence of corporate governance in different places and relates it to as an extension of management thought and then corporate social responsibility as an manifestation of the integration process.

Introduction:

Corporate governance though a common term today does not mean that it is a well understood term. There are many perspectives that come into play ranging from an unknown to a cliché with as many shades in between. Many of the existing literature has taken a rule based approach narrowing the broad spectrum under which it can be thought about. There are macro level institutional variables and also institutional variables all of which can be put in a perspective. The paper attempts to analyze corporate governance in the evolutionary approach of management thought. Management thought has been emerging ever since the industrial revolution and in response to the need of the organizational development. Organization is one of the most influential groups of the society and society being the final recipient of the company

Corporate governance: The Basic Issue

There is no dependable paradigm clearly defines the domain of corporate governance. It is a multidimensional concept. Corporate governance is basically concerned with the control of corporate bodies. Corporate governance in a nut shell means proper governing of, by the and for the corporate entity. The importance of profitability and performance of the companies are far exceeding by this need of being “Accountable” to the stake holders at large. Corporate governance laid the foundation that ensures this accountability. Once this is done firms are free to go their way to increase share holder value and growth. The interest in the corporate governance is due to two factors; one due to curious happenings in the corporate world and other due to globally mobile capital flows which highlights a difference in the corporate governance system in different parts of the world. In the developed countries corporate governance is the prerequisite of capital marker development. Investors can be encouraged to invest in corporate securities only if there is credible corporate governance in it. Poor corporate governance not only results in under-performance in the corporate economy but It also in the vulnerability of the entire financial system. While the thrust is on the accountability part there is also an equally important issue of autonomy. Corporate scandals may have made us more sensitive to accountability but the competitive forces of the markets desire the need of autonomy as well. Accountability without autonomy will surely dampen the risk taking and, innovativeness, the oxygen to business, and it may bring about a bureaucratic set up in business.

Corporate Governance: THE PERSPECTIVES

There are three distinct perspectives which emerge from the existing literature. These are the approaches to define and study the complex variables associated with it. The perspectives are:

1. Shareholder or capital market or control perspective.
2. Organizational or management or control perspective
3. Stake holder control

The first perspective is on the ground that shareholders are providers of risk capitals and so they have the final control over resource allocation decision. In reality the manager stake away this control and they may pursue their own interest in growth rather than profit. To prevent the resultant decline in company performance, stock market must enable shareholder to loosen managers' control over excess funds, thus achieve greater efficiency in resource allocation in the corporate economy

The second perspective believes that manager who coordinate the efforts of different factors of productions and who contribute by their skills and creativity to the production process generate surplus in the organization. Since they create profitable opportunity they must decide the resource allocation of the firm. The last but very important perspective is the stake holder-control perspective it is not share holder value maximization but well being of all groups with a stake in the long run success of a business should be the goal of the corporate governance. This approach takes into consideration the long term sustenance and efficiency of the firm. The stake holders involvement leads to long term value maximization of the firm. It is argued that neglect of other stake holders particularly employees' leads to underutilization of human skills.

The paradigm of management Evolution:

The Industrial revolution was not merely the invention of steam engine or the steam locomotive; it was a new era of 'culture rebirth'. The essence of industrial revolution was the substitution of human power by machine power. This brought three consequences and then onwards mankind growth became exponential. The first was that man kinds need became more complex and new means of satisfying these needs evolved. Secondly the scale of production needed transportation, communication. Thirdly the competition demanded cost reduction and innovations. With size came the need for managers, the motivated and disciplined workforce and the needed for planning organizing and controlling the enterprise. Many persons contributed for this and management as a discipline evolved. Many persons contributed to this evolution and to name a few we have the theories of

- 1 Robert Owen: the first to use moral punishment rather than corporal punishment. 'Silent monitors' indicating each days output of the workers through color cards. Though unsuccessful in many endeavors he was the first to sow seeds of 'human element' in industry.
- 2 Charls Babbage: he argued for division of labor as the essence of efficiency. The pioneer of method study. He visualized the harmony between the management and the workers by recognizing the mutuality of interest
- 3 Charls Dupin: His major contribution was introduction of management education. He recognized the difference between technical skill and managerial skill and the feasibility of teaching management education formally.
- 4 Fredric Winslow Taylor: the father of scientific management. The pioneer of time and motion study. He segregated between management and workers. Management was to do planning, organizing and controlling while labor would do a job as told in an efficient manner.
- 5 Henri Fayol: he developed fourteen principles of management which differentiated between management and administration. his major contribution was the idea of a search for general but at the same time flexible principles of management .

These management thoughts evolved in response to the need of the process to increase production as that was the time of prosperity. Resources were not a problem and they were addressing to a 'economic man'. They were applying the methods of science-systematic observation, impersonal observation and reproducible conclusions. They had a mechanical model of human being which was not sufficient. An alternative model evolved. The 'social man'. It all began with Hawthorn experiment at Western Electric, by Elton Mayo. It was not just technical terms but also the social norms that decided the output. That organization must be viewed as a social system. The great depression of 1929, mass suffering made the ideas of Mayo more humanistic in nature.

In the late fifties emerged a new trend called “organizational humanism”, contributed by Chris Argyris, who argued that the inherent tendency of human being to develop and mature was restricted by principles of management. The remedy for this is to go for a more ‘organic organization’.

The reason for the above introductory process of management thoughts is to highlight the management is an evolving science and a multidisciplinary approach. Organizations are not a closed system but an open system where the society is influencing and being influenced by organizations. While the presumed outcome of industrialization was improved life for people, the accomplishments were measured in terms of growth in mass production and consumption. The worth of human beings was in terms of their ability to contribute to the processes of production. The search for productive efficiency developed a value system that was production centric.

By 1970s, more people oriented perspectives were gaining grounds. The thought that to achieve desired improvements in the human well being the organizations can not afford to be but people centric. While the developing countries were struggling to develop the industrialized nations were themselves going in for transformation. More talks were on redefine the firm’s role in the society, and the demands that firms become more accountable to the society at large. The corporate responded to this need by a concept of social responsibility. In the preliminary approach it was more donations centric but it has evolved into maturity these days to more environmental concern

The current century has seen a spirited competition between a broad range of management theories and methods, however a realization that the purpose of work is to benefit people – both in its doing and in its product has been a long time in coming. The successful organization has to learn that it is not by pampering the people but challenging the people to achieve productivity. People centric organizations achieve profits through people, by challenging them to develop and utilize their ability. The secret is to provide people with opportunity to assume values and socially useful roles which allow them to apply their creativity and intellect for creating a better future for themselves and for the society.

The role of the organization as people centered, open to the needs of the society at large is where corporate governance comes into play. The ongoing process of management thought demands a broader definition and role of corporate governance. The argument of accountability and autonomy need to be balanced.

It is this context that difference is seen in the different corporate governance pattern in different parts of the world. The paper attempts to see the brief historic perspective, the pattern of corporate governance that emerged as a result. The major ones are the corporate governance of US, UK, German, Japanese.

Davis Global Advisers Inc. which is a consulting firm in Us has prepared a score card for different countries by comparing them on ten score card

A Board Structure

- 1 Code of best practices
- 2 Non –executive directors
- 3 Separation between positions of chairman and ceo
- 4 Board committees

B Voting Rights

- 5 voting procedure
- 6 voting rights
- 7 voting issues

C Disclosure

- 8 Accounting standards
- 9 Executive pay disclosure

D Take over Defenses

- 10 Take over barriers

According to the firm has given highest rank to UK for having most balanced score. The USA scores second. The historical perspective is analyzed in order to understand the emerged corporate governance pattern.

American corporate governance system:

For over a century from 1850 to 1970, the system was characterized by organizational control and since then there has been a shift towards capital market control perspective. The years after civil war the US economy expanded very rapidly. There were many mergers and acquisitions in railway, oil, steel and other capital and technology intensive industries. As a result the market got concentrated in few companies. By 1850svitself American companies had reached a critical pint where they needed a large capital to expand. At the same time the organizations had reached a point where complexities needed managerial expertise. This managerial expertise became the key input for success of the firm. To raise capital on such a large scale the net had to cast wide and general public had to be involved or appealed to. The share holders were fragmented and the many stock holders meant they were weak collectively. Weak stock holders and strong management was the feature of corporate government that emerged as a result. As business continued to raise capital from public, equity ownership was transferred from direct investors to portfolio investors. This enabled the entrepreneurs to retire from the industrial scene and their place was taken up by ambitious and competent executives. General Electric and AT&T, are such examples. Fragmented equity holders gave them enough scope to invest in modern plant and Technology. By 1960s the basic economic conditions had started to change because of foreign competition. And rise of institutional investors. Japanese corporations' began to challenge US business. Thus the way for market control perspective began. more and more managers were paid with stock options and the US stock market soared. Top top executives held shares, both ownership as well as control were integrated in their hands. American firms managed to revived their sagging profits by re-engineering and downsizing but they ignored the bases of competitive advantage such as new products, human capital etc.stake holders reacted to this and by applying pressure wherever they can. And this led to corporate stability. The emerging corporate governance reforms have concentrated on the following:

Greater role for non executive directors in holding managers accountable

Greater use of board committees to ensure that the board discharges its responsibility.
Efforts for greater disclosure to bring about transparency
Statutory regulation of auditors
Greater interest in governance of portfolio companies by public pension funds

British Corporate Governance System:

Today the perspective is strong capital market control system. Institutional investors started becoming important in UK since 1960s and their continuous search for higher and higher yields from portfolio investments is reflected in the high dividends pay out rates as compared to USA or Germany. British industry started lagging behind the American and German industry both technologically as well as organizationally because there was no managerial revolution in the UK. They continued with proprietary control for a long time. To meet the need for capital, public issues of non-voting, preference shares were common. Bank overdraft and retained earnings were the main source of finance. British banks never provided venture capital which German banks provided. The British financial community has taken more interest in foreign investments rather than industrial development. As a result the British has never seen an organizational control perspective on corporate governance. By the 1940s and 1950s many successful firms that still had proprietary control issued new equity shares to satisfy growing demand by portfolio investors. Because the British did not show any spectacular achievement in using and developing technology market control was soon established.

German Corporate Governance System

Organizational control is the dominant perspective of corporate governance in Germany. The corporate governance system consists of a network of institutional arrangements, such as company law, co-determination law, proxy voting system, cross holding and stock exchange regulations. In the nineteenth century the German companies also found it necessary to raise capital. But they did not go to the general public by issuing shares; they instead went to the public saving with banks. Banks have been a powerful source in the German corporate governance system. In the last part of nineteenth century, concentration of capital started taking place in different industries. Cartels and other loose combinations rather than mergers were preferred and so small firms continued to exist in the market. By 1990, managerial revolution started in German industry. Independent financial positions of

large companies were strengthened during the World War I on the basis of government orders which generated huge profits. During mid 1930 and 1940s the Nazis strengthened the inter company linkages. In the 1980s when capital market control was growing stronger in USA and the UK, the German companies were structuring their financial relation to strengthen their organizational control. The trend however is now towards liberalization of equity market and financial sector has greater incentive to yield through portfolio investments. Solid alliance between finance and industrial capital has been the main feature of German corporate governance.

Japanese Corporate Governance System:

The main feature of this system is heavy reliance on trust, implicit contracting and a relationship- oriented approach. There exists a strong tie up between banks and industry. Inter corporate cross holdings are also very prominent and holistic takeovers are very difficult. There is concentration on long term company interest, long term investment in employee training and R&D which gives the competitive edge to the Japanese company. Organizational –control perspective is the hallmark of Japanese corporate governance system. The roots of it are in 1870 where, postal saving system was mobilized in Japan to avoid foreign borrowing. It placed household savings in the hands of the government which made them available in to private banks that were interested in financing industries. Some of the Banks were ZAIBATSU, the family owned holding companies. Successful ZAIBATSU families played important role as venture capitalist. After the war, the Allied occupation dissolved the zaibatsu by distributing shares in holding company to the general public. In the 1950s the Japanese business community, led by top major industrial company and banks ,initiated a cross-holding movement to ensure that outside shareholders did not disrupt the workings of the industries . Japanese business brought blocks of each others share with the intent of remaining stable shareholders who would neither sell the shares in the market nor demand higher dividends. Thus organizational c-control was facilitate by and providing permanent employment and higher earnings to employees became major enterprise goals. Cross holdings are even today account for the biggest bulk of outstanding equity in Japan. Recently more mergers and acquisitions are seen in Japan. Competition is increasing there is a greater pressure on the financial institutions. Now investors are

becoming more demanding and are realizing the importance of maximum shareholder value as the goal of corporate governance.

Indian Corporate Governance System:

The Indian Corporate Governance system has the features of Anglo American system and some of the features of Japanese-German system. The share of small investors in the corporate equity is about 40 percent, which is about that in US, Inter corporate holdings, directors' promoters share in equity are also significant. Business networks are continued to control much of the private sector. These characteristics bring Indian corporate system to German –Japanese system. The first Indian company came into existence in 1960 in south India. The factory system of production was introduced around 1850 in cotton textiles and jute industries. Large scale extractions started in around that time. The British east India Company monopolized the trade between India and other countries till 1834. India had the system of managing agents in Europe and they had total grip over the companies, shareholders and they ensured that companies would remain in total control. In India they had to provide finance since the banking and capital markets were in the rudimentary stage of evolution. They made all important decisions in business on the strength of managing agency agreement. By 1913 they controlled the majority of jute and cotton mills, tea gardens, and coal mines in the country. As a result the corporate control did not remain with the individual companies but got vested in parent company, managing agents. After independence a program of planned development started with public sector. Between 1951 and 1958 Prof. Hazari analyzed 1000 companies in private sector and concluded that the mechanism of holding companies and interlocking directorships, business families had built, intermeshed pyramidal structures of control which they continued to consolidate. After nationalization of 14 major commercial banks in the country, development finance became the prime objective of the banking sector. Financial sectors were reformed in the 1990s. This set in motion the rapid reforms in capital market and banking sector. The major change was the removal of government control of the financial system. A new regime of greater disclosure, transparency and indirect control was brought in an independent market regulator. Indian corporate governance system is in a transition towards the Anglo-American corporate governance with a strong capital market. The perspective is market control is as yet quite distinct also has a hybrid nature because of feature of other corporate

governance system. This all is because of the historic perspective and is still in the evolutionary stage.

Corporate Social responsibility: A Perspective

Corporate social responsibility (CSR) is an expression used to describe what some see as a company's obligation to be sensitive to the needs of **all** of the stakeholders in its business operations.

A company's stakeholders are all those who are influenced by, or can influence, a company's decisions and actions. These can include (but are not limited to): employees, customers, suppliers, community organizations, subsidiaries and affiliates, joint venture partners, local neighborhoods, investors, and shareholders (or a sole owner).

CSR is closely linked with the principles of "Sustainable Development" in proposing that enterprises should be obliged to make decisions based not only on the financial/economic factors but also on the social and environmental consequences of their activities.

Today's heightened interest in the proper role of businesses in society has been promoted by increased sensitivity to environmental and ethical issues. Issues like environmental damage, improper treatment of workers, and faulty production leading to customers inconvenience or danger, are highlighted in the media. In some countries Government regulation regarding environmental and social issues has increased, and standards and laws are also often set at a supranational level (e.g. by the European Union). Some investors and investment fund managers have begun to take account of a corporation's CSR policy in making investment decisions. Some consumers have become increasingly sensitive to the CSR performance of the companies from which they buy their goods and services. These trends have contributed to the pressure on companies to operate in an economically, socially and environmentally sustainable way.

It is important to distinguish CSR from charitable donations and "good works" (i.e. philanthropy, e.g. Habitat for Humanity or Ronald McDonald House). Corporations have often, in the past, spent money on community projects, the endowment of scholarships, and the establishment of Foundations. They have also often encouraged their employees to

volunteer to take part in community work thereby create goodwill in the community which will directly enhance the reputation of the company and strengthen its brand. CSR goes beyond charity and requires that a responsible company will take into full account the impact on all stakeholders and on the environment when making decisions. This requires them to balance the needs of all stakeholders with their need to make a profit and reward their shareholders adequately.

A widely quoted definition by the World Business Council for Sustainable Development states that "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 at large". (CSR: Meeting Changing Expectations, 1999). This holistic approach to business regards organizations as (for example) being full partners in their communities, rather than seeing them more narrowly as being primarily in business to make profits and serve the needs of their shareholders. The application of the principles of Sustainable Development through the introduction of a CSR policy is often accompanied by what is called triple bottom line reporting which declares not only financial results but also the social and environmental impact of the business. Some countries (e.g. France) have made such reporting mandatory. However the measurement of social and environmental performance is difficult and new measurement techniques need to be developed.

Many large companies now produce annual reports that cover Sustainable Development and CSR issues, and these reports are often externally audited. But there is no common template for the reporting and the style and the evaluation methodology varies between companies (even within the same industry). The Global Reporting Initiative (GRI) is an attempt to standardize sustainability reporting and the AA1000 standard is an attempt to improve their legitimacy.

The benefits of CSR to businesses vary depending on the nature of the enterprise, and are typically very difficult to quantify. A major meta-analysis has been conducted seeking to draw a correlation between social/environmental performance and financial performance.

Some critics of CSR, such as the economist Milton Friedman, argue that a corporation's principal purpose is to maximize returns to its shareholders, whilst obeying the laws of the countries within which it works. Others argue that the only reason corporations put in place social projects is utilitarian; that they see a commercial benefit in raising their reputation with the public or with government. Proponents of CSR, however, would suggest a number of reasons why self-interested corporations, solely seeking to maximize profits are unable to advance the interests of society as a whole. Key challenges to the idea of CSR include: - the rule of corporate law that a corporation's directors are prohibited from any activity that would reduce profits - other mechanisms established to manage the principal-agent problem, such as accounting oversight, stock options, performance evaluations, deferred compensation and other mechanisms to increase accountability to shareholders.

Critics of the role of business in society argue that:

- Corporations care little for the welfare of workers, and given the opportunity will move production to sweatshops in less well regulated countries.
- Unchecked, companies will squander scarce resources.
- Companies do not pay the full costs of their impact. For example the costs of cleaning pollution often fall on society in general. As a result profits of corporations are enhanced at the expense of social or ecological welfare.
- Regulation is the best way to ensure that companies remain socially responsible.

Supporters of a more market based approach argue that:

- By and large, free markets and capitalism have been at the centre of economic and social development over the past two hundred years and that improvements in health, longevity or infant mortality (for example) have only been possible because economies (driven by free enterprise) have progressed.
- In order to attract quality workers, it is necessary for companies to offer better pay and conditions which leads to an overall rise in standards and to wealth creation.
- Investment in less developed countries contributes to the welfare of those societies, notwithstanding that these countries have fewer protections in place for workers. Failure to invest in these countries decreases the opportunity to increase social welfare.
- Free markets contribute to the effective management of scarce resources. The prices of many commodities have fallen in recent years. This contradicts the notion of scarcity, and may be attributed to improvements in technology leading to the more efficient use of resources.
- There are indeed occasions when externalities, such as the costs of pollution are not built into normal market prices in a free market. In these circumstances, regulatory intervention is important to redress the balance, to ensure that costs and benefits are correctly aligned.
- Whilst regulation is necessary in certain circumstances, over regulation creates barriers to entry into a market. These barriers increase the opportunities for excess profits, to the delight of the market participants, but do little to serve the interests of society as a whole. Some commentators are cynical about the true level of commitment of corporations to ideas like CSR and Sustainable Development, and their actual motivations for responsible behavior. Corporations that create the appearance of acting responsibly just for its public relations value are said to be "green washing."

Such commentators also say, citing Friedman's dictum, that the idea of an "ethical company" is an oxymoron, since the corporation is by its nature compelled to maximize its own interest, whatever the external price. Corporate executives and employees in turn have strong incentives to internalize the corporation's statutory obligations to maximize profits, sometimes to the extent that they abdicate their individual moral and ethical obligations as human beings. This tendency is, of course, encouraged by the desire to keep one's job, and by a system that judges and rewards performance strictly by bottom-line returns. The results of this tendency were clearly seen in the many corporate scandals of the late twentieth and early twenty-first centuries. So the CSR movement may perhaps be understood as an attempt not so much to regulate the activities of corporations per se, as to remind the people who constitute these corporations that they nonetheless have other responsibilities beyond the corporate ones. Because of this, it has become clear that a CSR activity generally can only be effective at achieving social or environmental outcomes to the extent that it maximizes profits: hence the CSR slogan - "doing well by doing good". Note that this requires that the resources applied to CSR activities must have a higher return than those resources could obtain if applied anywhere else, e.g. capital or productivity investment, lobbying for tax relief, outsourcing, off shoring, fighting against unionization, taking regulatory risks, or taking market risks - all of which are frequently-pursued strategies. This means that the possible scope of CSR activities is drastically narrowed. And corporations, with their constant incentive to maximize profits, often have identified all areas where profits could be increased, including those that have positive external social and environmental outcomes. The scope for CSR is thus narrowed to situations in which: 1. resources are available for investment 2. The CSR activity will yield higher profits than any other potential investment or activity 3. The corporation has been remiss in identifying this profit opportunity

Conclusion: The emergence of corporate social responsibility at a time when corporate governance is also at its coming of age is an indication of how the future of corporations plays a key role in the sustainable development of the society at large. The evolution of management thought from Robert Owen to Chris Agris to Mayo one side evolution of corporate governance to have more transparency and accountability and evolution of CRS from being community based social work to a stake holder in sustainable development is a positive step in the direction of societal development. The future synergy of these integrated concepts will benefit the society at large.

Thus the different systems of corporate governance can be traced in terms of the historic perspectives and as an extension on management thought. Anglo –American or the Japanese or the German system of corporate is an integration of the political, industrial, managerial, and economy evolutions. Corporate Governance is the system by which companies are directed and controlled by the management in the best interest of the stakeholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies.

Corporate Governance primarily involves transparency, full disclosure, independent monitoring of the state of affairs and being fair to all stakeholders.

The objective of corporate governance is not only to meet the statutory requirements but to go beyond by instituting systems and procedures as are in accordance with the latest requirements. The trends in the future will be:

- * Clear demarcation of roles and responsibilities
- * Performance Appraisal of Board Members and management
- * Succession planning.
- * Concept of Social Welfare

Ethics in the way business is carried out. Companies have certain social responsibilities to fulfill and existence of the companies without doing so would be difficult and meaningless.

In brief the issues in the corporate governance are who is controlling the company? What is the performance in terms of shareholders value addition/ and how this is done? Considering the emerging globalization of the economy 'how aspect is going to be standardized. The 'what 'aspect would of corporate governance is dependent on many factors and that would be different in different parts. According to experts the Asian Corporations would be gaining on this aspect and US corporations would be losing. However corporate governance would differentiate in the practices as required by the need of the society and its dependent variables. As the paradigm and perspectives are still expanding and the merging of different perspectives are still in progress it is important to remember that organization, management are a subsystem of the society and the ultimate accountability if to be considered in that broad framework.

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