MASTER OF BUSINESS ADMINISTRATION

Business Ethics and Corporate Governance

Regenesys
Business School
Awakening Potential

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Date of first draft:
Version number: 5.4_f
Date of Publication: April, 2014
Publisher: Regenesys Management: Sandton

Document Change History

Date	Version	Initials	Description of Change
6 February 2013	1	LM	First draft to be reviewed and updated
12 February 2013	2	LM	First draft submitted
15 February 2013	4	LM	SME recommendations implemented
18 February 2013	5	LC	Final approval
16 August 2013	5_f	FVS	Formatting
22 August 2013	5.1	SH	SME review
20 August 2013	5.1	LM	Formatted to new template. Referencing updated.
27 January 2014	5.2	LM	Revisions made based on SME fix-it comments. Formatted to new template. Articles changed to Emerald.
10 February 2014	5.2_f	FVS	Formatting
7 April 2014	5.3_f	FVS	Updating references
11 April 2014	5.4	PDW	Update articles to Emerald in module
19 June 2014	5.4_f	SK	Final formatting

This Study Guide highlights key focus areas for you as a student. Because the field of study in question is so vast, it is critical that you consult additional literature.

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1. WELCOME TO REGENESYS

"Have a vision. Think big. Dream, persevere and your vision will become a reality. Awaken your potential knowing that everything you need is within you."
Dr. Marko Saravanja

At Regenesys, we help individuals and organisations to achieve their personal and organisational goals, by enhancing their management and leadership potential. We approach education and development holistically, considering every interaction not only from an intellectual perspective but also in terms of emotion and spirituality. Our learning programmes are designed to transform and inspire your mind, heart and soul, and thus allow you to develop the positive values, attitudes and behaviours, which are required for success.

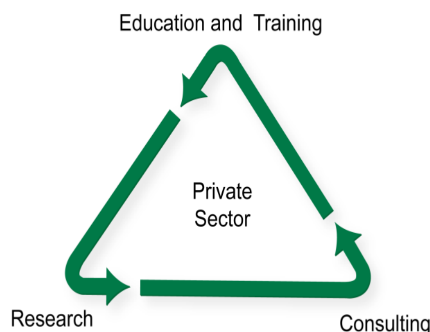
Having educated over 95 000 students based in highly reputable local and international corporations across more than 100 countries since the inception of Regenesys' in 1998, we are now one of the fastest-growing and leading institutions of management and leadership development in the world.

Regenesys' ISO 9001:2008 accreditation bears testimony to our quality management systems meeting international standards. Regenesys is accredited with the Council on Higher Education. Our work is rooted in the realities of a rapidly changing world and we provide our clients with the knowledge, skills and values required for success in the 21st century.

At Regenesys, you will be treated with respect, care and professionalism. You will be taught by business experts, entrepreneurs and academics who are inspired by their passion for human development. You will be at a place where business and government leaders meet, network, share their experiences and knowledge, learn from each other, and develop business relationships. You will have access to a campus, in the heart of Sandton, with the tranquillity of a Zen garden, gym and meditation room.

We encourage you to embark on a journey of personal development with Regenesys. We will help you to awaken your potential and to realise that everything you need to succeed is within you. We will be with you every step of the way. We will work hard with you and, at the end celebrate your success with you.

Areas of Expertise



2. INTRODUCTION

Welcome to the module on Business Ethics and Corporate Governance (BECG).

Business is often seen as activities conducted for the singular pursuit of profit. As long as organisations are operating within the confines of the law and making sustainable returns, they are seen as fulfilling their purpose. However, organisations also need to maintain certain ethical standards.

This is because corporations are not isolated institutions. Local and global communities increasingly demand that ethical behaviour become an integrated part of businesses. Generally speaking then, ethics form a part of corporate governance.

Corporate governance has no universally accepted definition, but is broadly defined as the regulations and controls that determine how a company is run. In this module, you will study what these regulations and controls are and how these relate to business ethics.

2.1 TEACHING AND LEARNING METHODOLOGY

Regenesys uses an interactive teaching and learning methodology that encourages self-reflection and promotes independent and critical thinking. Key to the approach utilised is an understanding of adult learning principles, which recognise the maturity and experience of participants, and the way that adult students need to learn.

At the core of this is the integration of new knowledge and skills into existing knowledge structures, as well as the importance of seeing the relevance of all learning via immediate application in the workplace.

Practical exercises are used to create a simulated management experience to ensure that the conceptual knowledge and practical skills acquired can be directly applied within the work environment of the participants. The activities may include scenarios, case studies, self-reflection, problem solving and planning tasks.

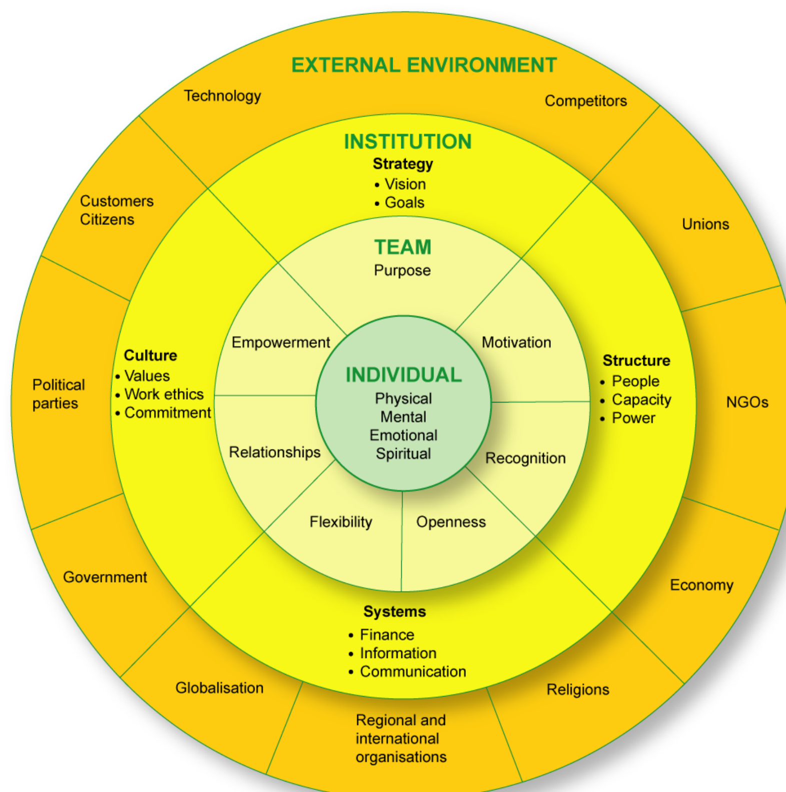
Training manuals are developed to cover all essential aspects of the training comprehensively in a user-friendly and interactive format. Our facilitators have extensive experience in management education, training and development.

Please read through this study guide carefully, as it will influence your understanding of the subject matter and the successful planning and completion of your studies.

2.2 Aligning Organisational, Team and Individual Objectives

This course will draw on a model developed by Regenesys Management, demonstrating how the external environment, the levels of an organisation, the team and the components of an individual are interrelated in a dynamic and systemic way. The success of an individual depends on his or her self-awareness, knowledge and ability to manage successfully these interdependent forces, stakeholders and processes.

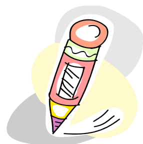
The degree of *synergy* and *alignment* between the goals and objectives of the organisation, the team and the individual determines the success or failure of an organisation. It is, therefore, imperative that each organisation ensures that team and individual goals and objectives are aligned with the *organisation's strategies* (vision, mission, goals and objectives, etc); *structure* (organogram, decision-making structure, etc); *systems* (HR, finance, communication, administration, information, etc); *culture* (values, level of openness, democracy, caring, etc). An effective work environment should be characterised by the alignment of organisational systems, strategies, structures and culture, and by people who operate synergistically.



Regenesys' Integrated Management Model

3. Icons used in this Study Guide

Icons are included in the study guide to enhance its usability. Certain icons are used to indicate different important aspects in the study guide to help you to use it more effectively as a reference guide. The icons in this Study Guide should be interpreted as follows:



Definition

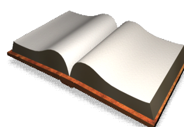
The definitions provide an academic perspective on given terminology. They are used to give students a frame of reference from which to define a term using their own words.

Examples

The example icon is used to indicate additional text that illustrates the content under discussion. This includes templates, simple calculations, problem solutions, etc.

Video clip or presentation

This icon indicates a hyperlink to a video clip or presentation on the subject matter for discussion. It is recommended that students follow the link and listen to or read the material it provides.



Interesting source to consult

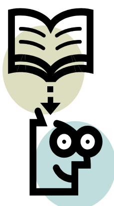
The source icon is used to indicate text sources, from the internet or resource centre, which add to the content of the topic being discussed

In a nutshell

This icon indicates a summary of the content of a section in the workbook and is used to emphasise an important issue.

Calculations

This icon indicates mathematical or linguistic formulae and calculations.



Self-reflection

Students complete the self-reflection activity in their own time. It requires students to think further about an issue raised in class or in the learning materials. In certain instances, students may be required to add their views to their assignments.

Tasks

The task icon indicates work activities that contact students must complete during class. These tasks will be discussed in class and reflected upon by students and facilitators. E-learning students can use these tasks simply to reinforce their knowledge.

Note

This icon indicates important information of which to take note.

4. Study Material For The Module

You have received material that includes:

- Study guide;
- Recommended reading; and
- Assignment.

These resources provide you with a starting point from which to study the contents of this module. Additional resources to help you complete this module will be provided online via the link to this module. Guidance on how to access the material is provided in the Academic Handbook you received when you registered for this qualification.

5. Recommended Resources

A number of recommended resources have been identified to help you complete this module.

5.1 Recommended Reading

The following textbook is recommended and must be used to complete the module:

- Velasquez, M.G. 2012, *Business Ethics: Concepts and Cases*, 7th International Edition, Cape Town: Pearson.

Please ensure you order, or download your textbook, before you start with the module.

5.2 Recommended Articles

- AngloGold Ashanti. 2013, 'Corporate Governance Policies', http://www.anglogold.co.za/About+our+business/Gov+Policies.htm (accessed 10 April 2014).

- Apple. 2012, 'Corporate Governance Guidelines', http://files.shareholder.com/downloads/AAPL/1698087593x0x443011/6a7d49f1-a3af-4e69-b279-021b81a93cdf/governance_guidelines.pdf (accessed 10 April 2014).

- Ardichvili, A., Jondle, D., Kowske, B., Cornachione, E., Li, J. and Thakadipuram. 2010, 'Ethical Business Practices in BRICs: Comparing Perceptions of Managers and Employees in Brazil, Russia, India and China,

and G7 Nations', Society for Business Ethics Annual Meeting', 2010, Center for Ethical Business Cultures, University of St. Thomas, http://www.cebcglobal.org/uploaded_files/Ethical_Business_Practices_in_BRICs.pdf (accessed 10 April 2014).

- Bogaards, M., Mpinganjira, M., Svensson, G. and Mysen, T. 2012, 'A framework of conscientious corporate brand – a South African validation', *Corporate Governance*, 12 (5), 675-685, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=12&issue=5&articleid=17062466&show=html (accessed 10 April 2014).
- Bushman, R.M. Piotroski, J.D. and Smith, A.B. 2003, 'What determines corporate transparency?' http://public.kenan-flagler.unc.edu/faculty/bushmanr/bushman_jar_transparency.pdf (accessed 10 April 2014).
- European Corporate Governance Institute, 2013, 'Index of Codes', http://www.ecgi.org/codes/all_codes.php (accessed 10 April 2014).
- Holme, C. 2008, 'Business ethics – Part One: Does it matter?', *Industrial and Commercial Training*, 40 (5), 248-252. http://www.emeraldinsight.com/journals.htm?issn=0019-7858&volume=40&issue=5&articleid=1733323&show=html (accessed 10 April 2014).
- Hyson, P. 2013, 'The spirited leader: the potential of spiritual intelligence to improve leadership', *The International Journal of Leadership in Public Services*, 9 (3/4), 109-115, http://www.emeraldinsight.com/journals.htm?issn=1747-9886&volume=9&issue=3/4&articleid=17102118&show=html (accessed 10 April 2014).
- KulshanCLT, 2013, 'Community Investing', http://www.kulshanclt.org/about-kulshanclt-homestead-version/ (accessed 7 April 2014).
- McGee, S. 2012, 'Murdoch and McClendon: Poster Boys for Bad Governance', http://www.thefiscaltimes.com/Columns/2012/05/07/Murdoch-and-McClendon-Poster-Boys-for-Bad-Governance.aspx#page1 (accessed 10 April 2014).
- McLaughlin, C. 2005, 'Spirituality and ethics in business', *European Business Review*, 17 (1), http://www.emeraldinsight.com/journals.htm?issn=0955-534X&volume=17&issue=1&articleid=1500660&show=html (accessed 30 January 2014).
- Merton, R.C. 2013, 'Innovation: How to Make Smarter Decisions', *Harvard Business Review*, April 2013, http://hbr.org/2013/04/innovation-risk-how-to-make-smarter-decisions/ar/1 (accessed 10 April 2014).
- Mohammed, M. 2013, 'Corporate accountability in the context of sustainability – a conceptual framework', *EuroMed Journal of Business*, 8 (3), 243-254, http://www.emeraldinsight.com/journals.htm?issn=1450-2194&volume=8&issue=3&articleid=17097063&show=html (accessed 10 April 2014).
- Parker, S., Peters, G.F. and Turetsky, H.F. 2002, 'Corporate governance and corporate failure: A survival analysis', *Corporate Governance*, 2 (2), 4-12, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=2&articleid=873145&show=html (accessed 10 April 2014).
- Petrick, J.A. and Scherer, R.F. 'The Enron Scandal and the Neglect of Management Integrity Capacity', *Mid-American Journal of Business*, 18 (1), 37-49, http://www.emeraldinsight.com/journals.htm?issn=1935-5181&volume=18&issue=1&articleid=1917819&show=html (accessed 29 January 2014).

- Robins, F. 2010, 'Learning from corporate mistakes', *Corporate Communications: An International Journal*, 15 (2), 169-180, http://www.emeraldinsight.com/journals.htm?issn=1356-3289&volume=15&issue=2&articleid=1858828&show=html (accessed 27 January 2014).

- Saica. 2009, 'Summary of Report on Governance for South Africa – 2009 (King III)', http://www.mmbconsulting.co.za/images/KINGIII_SUMMARY_OF_REPORT_ON_GOVERNANCE_FOR_SOUTH_AFRICA.pdf (accessed 7 April 2014).

- Samsung Electronics, 2014, 'Corporate Citizenship,' http://www.samsung.com/za/aboutsamsung/samsungelectronics/corporatecitizenship/whatwecareabout.html (accessed 7 April 2014).

- Starbucks, 2013, 'Being a Responsible Company', http://www.starbucks.com/responsibility (accessed 10 April 2014).

- Talamo, G. 2011, 'Corporate governance and capital flows', *Corporate Governance*, 4 (4), 29-46. http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 29 January 2014).

- Thomsen, S. 2004, 'Corporate values and corporate governance', *Corporate Governance*, 4 (4), 29-46, ,http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 11 April 2014).

- Tran, B. 'Paradigms in corporate ethics: the legality and values of corporate ethics', *Social Responsibility Journal, 40* (1/2), 158-171, http://www.emeraldinsight.com/journals.htm?issn=1747-1117&volume=4&issue=1/2&articleid=1717916&show=html (accessed 11 April 2014).

- Vinten, G. 2002, 'The corporate governance lessons of Enron', *Corporate Governance*, 2 (4), 4-9, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=4&articleid=873155&show=html , (accessed 11 April 2014).

- Virgin Media, 2012, 'Code of Conduct', http://investors.virginmedia.com/phoenix.zhtml?c=135485&p=irol-govconduct , (accessed 10 April 2014).

Additional articles that may prompt discussions and further assist you in completing this course will be saved on **Regenesys Online** under the relevant course. Please visit the site regularly to access these additional sources.

5.3 Recommended Multimedia

- 3blmedia, 2012, 'Walt Disney Director of Corporate Citizenship' [video clip], http://www.youtube.com/watch?v=a3Rt8eVp6GY (accessed 10 April 2014).
- Ask the Ethics Guy, 2011, 'Risk Management Vs Ethics' [video], http://www.youtube.com/watch?v=C0NRPC27EGc (accessed 10 April 2014).
- Development Crossing, 2009, 'Did You Know? Corporate Social Responsibility', http://www.youtube.com/watch?v=GggyVO21hw8 (accessed 10 April 2014).
- Fbucaro, 2011, 'The Importance of Ethics in Business' [video clip], http://www.youtube.com/watch?v=nJf3JhaiHtQ (accessed 10 April 2014).
- Maia, B. 'Corporate governance on BRICs: A mountain to climb' [video], http://www.youtube.com/watch?v=dyn9UwNo820 (accessed 10 April 2014).
- Powell, C., Range, K. and Williams, J. 2009, 'Shell Oil in Nigeria' [slide show], http://www.slideshare.net/kran2796/shell-oil-in-nigeria-case-study (accessed 10 April 2014).
- UNSW, 2011, 'Corporate Governance: What do Shareholders Really Value?' [Video clip], http://www.youtube.com/watch?v=X2t2bES5y9s (accessed 10 April 2014).

5.4 Additional Sources to Consult

As a higher education student, you are responsible for sourcing additional information that will assist you in completing this module successfully. Below is a list of sources that you can consult to obtain additional information on the topics to be discussed in this module:

Emerald	This is an online database containing journal articles that are relevant to your modules. Please refer to the attached Emerald manual to assist you to download required articles. Information on how to access Emerald is provided to you in your Academic Handbook. You will receive access to the database once you register as a student.
NetMBA:	This is one of several web sites that provide a selection of MBA constructs and discussion. It is one of the better of these addresses. http://www.netmba.com/
MindTools:	MindTools.com is a very useful source of ideas, constructs, management models, etc with even more useful commentary and description. http://www.mindtools.com/
Brunel Open Learning Archive:	A Brunel University support-site that provides an easily accessible library of ideas, concepts, constructs techniques, tools, models, etc. http://www.brunel.ac.uk/
ProvenModels:	ProvenModels' Digital Model Book presents digitalised management models categorised in a clear, consistent and standardised information structure to improve the usability and reusability of management literature. Management models are important generalisations of business situations when applied in context and are powerful tools for solving business issues. http://www.provenmodels.com/
12manage.com:	This is a website on which one can access numerous models as well as global comments on the models and principles. This could also serve as a place where you could voice your ideas and get feedback from all over the world. http://www.12manage.com/
The Free Management Library:	The Free Management Library can be used to improve your organisation, and for your own personal, professional and organisational development. This is by far the most comprehensive overview of all aspects of strategic planning covering all stages of the process. http://www.managementhelp.org/np_progs/sp_mod/str_plan.htm

There are many more sites and articles available that can help you to successfully complete this module. You are encouraged to post on the *Regenesys Learning Platform* the website addresses of any additional interesting sites that you come across. In this way you can help other students access the same wonderful information that you have discovered.

A word of caution – not all information available on the internet is necessarily of a high academic standard. It is therefore recommended that you always compare information that you obtain with that contained in accredited sources such as articles that were published in accredited journals.

6. LEARNING OUTCOMES

Upon completing this course, students should be able to:

- Explain the concept of corporate governance as well as roles and responsibilities around corporate governance;
- Understand the concept of values (our own and others'), and recognise the impact thereof upon our business ethics;
- Clarify the need for creating a common set of values within an organisational business ethics framework;
- Critically examine how ethics impact upon business and profitability;
- Understand your business in relation to the community's ethical framework including concepts of transparency, social responsibility, equity etc;
- Develop a critical understanding of the legal nature of a company by critically analysing the separate legal personality and its application to corporate governance;
- Critically examine terminology to understand how governance and control measures are applied in the business environment;
- Critically analyse accountability in terms of alignment with legislation, regulations and the codes relating to corporate governance and ethics by focusing on the roles and responsibilities of the directors, board committees, auditor and company secretary;
- Demonstrate understanding of the legal duties of the directors by understanding and analysing their fiduciary duties and their duties of care and skill;
- Demonstrate a critical understanding of the importance of risk management as a key role of the board of directors to develop and manage risk in the business environment;
- Critically analyse the importance of risk management by studying case studies of poor corporate governance that has resulted in corporate collapse;
- Apply the King III Code of Governance to a business environment in accordance with the King III Report recommendations;
- Critically analyse principles of ethics and ethical leadership by demonstrating a critical understanding of the importance of business ethics in a business environment; and
- Apply case studies to demonstrate the value and importance of corporate governance to understand the importance and value of corporate governance in developing good corporate citizens in the economy.

7. Content Scope and Learning Guidance

A number of topics will be covered to assist you in successfully achieving the learning outcomes of this module. It is important to study each of these sections to ensure that you expand your knowledge in the subject and are able to complete the required assessments. The sections that will be dealt with include:

Section 1	An Introduction to Business Ethics and Corporate Governance
Section 2	Managing Ethics in Business
Section 3	Regulating Business Ethics and Corporate Governance in BRICS countries
Section 4	Risk Management

A more detailed framework of what is required for each of these topics follows under each section heading. A number of questions to probe discussion and guide you towards comprehension and insight are also provided.

The timetable under each section heading provides guidance on the time to be spent to study each section. It is recommended that you follow the given timetable to ensure that you spend the appropriate amount of time on each section. Following the timetable will ensure that you have covered the required sections relevant to each assignment and have appropriate time to prepare for the examination.

7.1 An Introduction to Business Ethics and Corporate Governance

Timeframe:	Minimum 40 hours
Learning outcomes:	• Explain the concept of corporate governance as well as roles and responsibilities around corporate governance. • Understand the concept of values (our own and others'), and recognise the impact thereof upon our business ethics. • Apply case studies to demonstrate the value and importance of corporate governance to understand the importance and value of corporate governance in developing good corporate citizens in the economy.
Recommended reading:	• AngloGold Ashanti, 2013, 'Corporate Governance Policies', http://www.anglogold.co.za/About+our+business/Gov+Policies.htm (accessed 10 April 2014). • Apple, 'Corporate Governance Guidelines.' http://files.shareholder.com/downloads/AAPL/1698087593x0x443011/6a7d49f1-a3af-4e69-b279-021b81a93cdf/governance_guidelines.pdf (accessed 10 April 2014). • Bogaards, M., Mpinganjira, M., Svensson, G. and Mysen, T. 2012, 'A framework of conscientious corporate brand – a South African validation', *Corporate Governance*, 12 (5), 675-685, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=12&issue=5&articleid=17062466&show=html (accessed 10 April 2014). • Holme, C. 2008, 'Business ethics – Part One: Does it matter?', *Industrial and Commercial Training*, 40 (5), 248-252. http://www.emeraldinsight.com/journals.htm?issn=0019-7858&volume=40&issue=5&articleid=1733323&show=html (accessed 10 April 2014). • Hyson, P. 2013, 'The spirited leader: the potential of spiritual intelligence to improve leadership', *The International Journal of Leadership in Public Services*, 9 (3/4), 109-115, http://www.emeraldinsight.com/journals.htm?issn=1747-9886&volume=9&issue=3/4&articleid=17102118&show=html (accessed 10 April 2014). • McGee, S. 2012, 'Murdoch and McClendon: Poster Boys for Bad Governance', http://www.thefiscaltimes.com/Columns/2012/05/07/Murdoch-and-McClendon-Poster-Boys-for-Bad-Governance.aspx#page1 (accessed 10 April 2014). • McLaughlin, C. 2005, 'Spirituality and ethics in business', *European Business Review*, 17 (1), http://www.emeraldinsight.com/journals.htm?issn=0955-534X&volume=17&issue=1&articleid=1500660&show=html (accessed 10 April 2014). • Parker, S., Peters, G.F. and Turetsky, H.F. 2002, 'Corporate governance and corporate failure: A survival analysis', *Corporate Governance*, 2 (2), 4-12, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=2&articleid=873145&show=html (accessed 10 April 2014). • Talamo, G. 2011, 'Corporate governance and capital flows', *Corporate Governance*, 4 (4), 29-46. http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 10 April 2014). • Thomsen, S. 2004, 'Corporate values and corporate governance', *Corporate Governance*, 4 (4), 29-46, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 10 April 2014).

	• Tran, B. 'Paradigms in corporate ethics: the legality and values of corporate ethics', *Social Responsibility Journal, 40* (1/2), 158-171, http://www.emeraldinsight.com/journals.htm?issn=1747-1117&volume=4&issue=1/2&articleid=1717916&show=html (accessed 10 April 2014).
Recommended Multimedia:	• UNSW, 2011, 'Corporate Governance: What do Shareholders Really Value?' [video clip], http://www.youtube.com/watch?v=X2t2bES5y9s (accessed 10 April 2014). • 3blmedia, 2012, 'Walt Disney Director of Corporate Citizenship' [video clip], http://www.youtube.com/watch?v=a3Rt8eVp6GY (accessed 10 April 2014).
Section overview:	This section serves to introduce the student to the concept of corporate governance, especially as it applies in the context of business ethics.

7.1.1 Introduction to Business Ethics and Corporate Governance

Towards the end of the twentieth-century, most businesses were driven by the pursuit of profit alone without concern for ethical behaviour. For this reason, the 1980s came to be seen as the epoch of corporate greed and meaningless consumerism.

However in the late 1980s this attitude changed as news of unethical business practices became more widespread and more disturbing. Such news was met with demands from consumers and shareholders that businesses re-think how they treated people and the environment, and how they operated in countries that were responsible for human rights violations (e.g. companies providing arms to the apartheid government in South Africa).

These demands intensified after the 1989 spill of the Exxon Valdez, the 1995 sinking of Shell's Brent Spar oil platform, and the killing of activists by the Nigerian military, funded by Shell.

No longer could profits be ruthlessly pursued, without taking into account the ethical repercussions of a company's business ethics. During the 1990s, with the birth of the "New Age Company", corporations began to change – pursuing "profits with principles" (Nichols, 1994:2). This was partly a response to the new business professional, someone who longed for more meaningful work, and partly a response to the fallout of big business at the close of the previous decade.

Since then, companies have evolved from purely profit-driven organisations to businesses, which must consider ethics and values in every aspect of strategy and human resource planning. This is not only to adhere to legal requirements, but also to ensure good corporate governance.

In order to understand this shift better, we need to examine the terms 'business ethics' and 'corporate governance' more closely, and evaluate the reasons that businesses are now following the standards of ethical conduct.

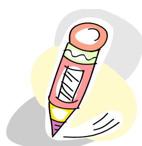
7.1.2 Corporate Governance

Corporate governance refers to the internal control mechanisms that regulate and protect the corporation from the human controllers. In its narrowest sense, corporate governance refers to the formal system of accountability of the directorate to the corporation.

In the broader sense, corporate governance refers to sets of relationships between the business and all of its stakeholders. An organisation needs to consider both its internal and external stakeholders when formulating strategies in order to align its interests with those of the society in which it is operating.

Defining corporate governance

Consider the definitions of corporate governance offered below:



"The framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with all its stakeholders (financiers, customers, management, employees, government, and the community)."

(Businessdictionary.com, n.d)

"Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital."

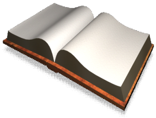
(IFC Corporate Governance, 2012)

"How a company is managed, in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. The concept encompasses a variety of issues, including disclosure of information to shareholders and board members, remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures, etc."

(The Financial Times, 2013)

These definitions point to the roles and responsibilities of relevant stakeholders. The key roles and responsibilities of the board of directors are to ensure accountability, fairness and transparency in its interactions with the stakeholders. The role of the board of directors will be discussed in greater depth in a later section of this Study Guide.

Read the following articles on corporate governance:



Parker, S., Peters, G.F. and Turetsky, H.F. 2002, 'Corporate governance and corporate failure: A survival analysis', *Corporate Governance*, 2 (2), 4-12, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=2&articleid=873145&show=html (accessed 10 April 2014).

Talamo, G. 2011, 'Corporate governance and capital flows', *Corporate Governance*, 4 (4), 29-46. http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 10 April 2014).

Task Questions

1. Using the articles above, critique the definitions of corporate governance the authors present.
2. Assess the importance of corporate governance in your own business.
3. Explain the purpose of corporate governance in light of corporate failure.

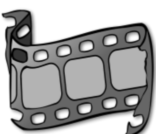
Stakeholders and corporate governance

Stakeholders play a critical role in strategic management. Any organisation's business strategy must consider stakeholder expectations and how best to involve stakeholders positively and constructively to achieve successful results. Corporate governance is concerned with achieving these results by resolving collective action problems between dispersed investors and reconciling conflicts of interest between stakeholders (Becht, Bolton and Röell, 2005:1).

These conflicts of interest can be solved by the following mechanisms of corporate governance:

- Control of the company by a few large investors;
- Hostile takeovers;
- Concentration of control by the board of directors;
- Investors and managerial interests aligned; and
- Defined fiduciary duties for CEOs.

Watch the following video to understand how corporations can rethink their approach to business strategy based on shareholder value:



UNSW, 2011, 'Corporate Governance: What do Shareholders Really Value?' [video clip], http://www.youtube.com/watch?v=X2t2bES5y9s (accessed 04 February 2013).

Corporate governance provides the internal control framework to ensure that the organisation formulates and manages its strategies and adopts a strategic direction in an ethical manner.

The approach to stakeholder relationships is a key aspect of corporate governance. West (2006) discusses the different approaches to stakeholder relationships by contrasting the shareholder model from the stakeholder model of corporate governance.

In developing a corporate governance strategy, the organisation must establish the following:

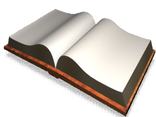
- The nature of the business;
- Assessment of the internal and external business environments;
- Vision and mission;
- Goals and objectives;
- Key stakeholders;
- Competitive advantage;
- Risk management; and
- Risk-based internal audit.

Non-profit organisations like profit organisations must aim for competitive advantage or institutional advantage to demonstrate that they are managing their operations more effectively.

This might have to be done within the context of national corporate governance concerns where guidelines might exist that corporations are urged to follow.

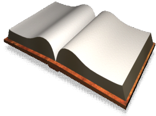
However, while what we have discussed may be helpful in forming a general idea of corporate governance, there is no universal definition for corporate governance. Each organisation has its own unique strategic vision and therefore each organisation must consider its own unique understanding of what corporate governance means so that systems appropriate to the strategy are developed. It should be fairly clear that there is no universal corporate governance definition. You are encouraged to reflect and consider your own organisation to formulate a definition, which would fit the way corporate governance is implemented in your organisation.

Access the link below to read the corporate governance policy documents of AngloGold Ashanti (available in multiple languages):



AngloGold Ashanti, 2013, ‘Corporate Governance Policies’, http://www.anglogold.co.za/About+our+business/Gov+Policies.htm (accessed 10 April 2014).

It might be useful to also consult Apple's corporate governance policy document in order to compare corporate governance documentation:



Apple, 'Corporate Governance Guidelines.' Viewed 14 February. http://files.shareholder.com/downloads/AAPL/1698087593x0x443011/6a7d49f1-a3af-4e69-b279-021b81a93cdf/governance_guidelines.pdf (accessed 10 April 2014).

The outcome of corporate governance should be good corporate citizenship, therefore it is necessary to consider this term.

Corporate citizenship

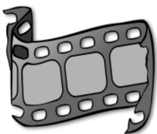
Corporate governance deals with the internal checks, balances, systems and values of the organisation, whereas good corporate citizenship deals with external relationships and its impact on the organisation and society.

Corporate citizenship may be defined as the extent to which an organisation makes a positive contribution to society by respecting its stakeholders. It also encapsulates good ethical values, compliance with legislation, rules and regulations.

Corporate citizenship includes:

- Human rights;
- Respect for the environment;
- Transformation;
- Workplace equity;
- Skills;
- Employees;
- Procurement;
- Stakeholders;
- Society; and
- Social investment.

Watch the following clip to understand the Walt Disney Corporation's approach to corporate citizenship:



3blmedia, 2012, 'Walt Disney Director of Corporate Citizenship' [video clip], http://www.youtube.com/watch?v=a3Rt8eVp6GY (accessed 10 April 2014).

There is an overlap between corporate citizenship and corporate governance. The focus of corporate citizenship is broader than corporate governance since its focus is on issues external to the organisation.

Globally corporate citizenship includes contemporary issues such as environmental, corporate social responsibility and integrated triple bottom line reporting to ensure sustainability. Corporate governance is narrower, since its focus is on the internal affairs and control mechanisms within the organisation.

Read the following newspaper article, and then answer the questions that follow:

McGee, S. 2012, 'Murdoch and McClendon: Poster Boys for Bad Governance', http://www.thefiscaltimes.com/Columns/2012/05/07/Murdoch-and-McClendon-Poster-Boys-for-Bad-Governance.aspx#page1 (accessed 10 April 2014).

Task Questions

1. Using the article and your own research, explain why corporate governance is important in developing good corporate citizens.
2. Evaluate other examples from the business world that support the importance of corporate governance, especially in creating good corporate citizens.

7.1.3 Defining Business Ethics

Definition of ethics

Velasquez (2012:8) defines ethics as "the study of morality." Ethics has also been defined as "A set of principles of right conduct" and "A theory of moral values" (thefreedictionary, 2014). In order to understand ethics, therefore, we need to unpack what we mean by 'morality', 'principles' and 'right conduct.'

Morality

Simply put, morality is "the standards that an individual or group has about what is right and wrong, good and evil" (Velasquez, 2012:8). Morality compels you to act in accordance with what you believe is right and, conversely, not do what you consider is wrong.

Principles

Principles form the foundation of our belief systems – they are the "fundamental truths" underpinning our behaviour (Oxforddictionaries.com, 2014).

Right conduct

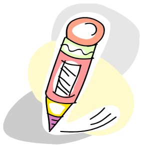
Right conduct refers to action that is guided by principles and morals – in other words, behaviour that is considered right in your society and that is underpinned by principles.

Task Questions

1. Using the components of ethics discussed above, evaluate what constitutes ethical behaviour in your society.

Definition of business ethics

As Velasquez (2012:1) notes, "Business ethics is applied ethics." This implies taking principles, morality and right conduct and applying these in a business context. Applied business ethics can be understood as:



"A specialised study of moral right and wrong that concentrates on moral standards as they apply to business institutions, organisations, and behaviour."

(Velasquez, 2012:15)

"The critical, structured examination of how people and institutions should behave in the world of commerce. In particular, it involves examining appropriate constraints on the pursuit of self-interest, or (for firms) profits, when the actions of individuals or firms affects others."

(Businessethics.ca, n.d)

"Business ethics is the accepted set of moral values and corporate standards of conduct in a business organisation. The specifics of what this actually means can vary from one organisation to another."

(Merchant, 2012)

Using these definitions, we could say that in the business world, ethics is the study of morally appropriate behaviour and decisions, examining what “should be done” (Chumir Ethics Foundation, n.d).

It might be useful to pause and consider the definition of business ethics as offered by Merchant (2012). This is because he acknowledges that like corporate governance, business ethics differ from one corporation to the next.

While this is true, and we should keep our own organisational cultures in the back of our minds when we think about business ethics, as the definition from Investopedia illustrates, there are also laws, which regulate the ethical practices of corporations that companies cannot ignore. We will address these laws in detail later on.

The fundamental difference between ethics and business ethics is as follows Holme (2008:248):

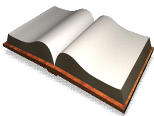
Ethics – a moral principle or set of moral values held by an individual.
Business ethics – a set of moral principles for arriving at a decision within the values of the organisation.

Task Questions

1. Velasquez (2012:1) defines business ethics as "applied ethics." Describe the application of ethics in your business environment.

Why business ethics?

Read the following articles and then answer the task questions that follow:



- Bogaards, M., Mpinganjira, M., Svensson, G. and Mysen, T. 2012, 'A framework of conscientious corporate brand – a South African validation', *Corporate Governance*, 12 (5), 675-685, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=12&issue=5&articleid=17062466&show=html (accessed 10 April 2014).
- Holme, C. 2008, 'Business ethics – Part One: Does it matter?', *Industrial and Commercial Training*, 40 (5), 248-252. http://www.emeraldinsight.com/journals.htm?issn=0019-7858&volume=40&issue=5&articleid=1733323&show=html (accessed 10 April 2014).
- Tran, B. 'Paradigms in corporate ethics: the legality and values of corporate ethics', *Social Responsibility Journal, 40* (1/2), 158-171, http://www.emeraldinsight.com/journals.htm?issn=1747-1117&volume=4&issue=1/2&articleid=1717916&show=html (accessed 10 April 2014).

Task Questions

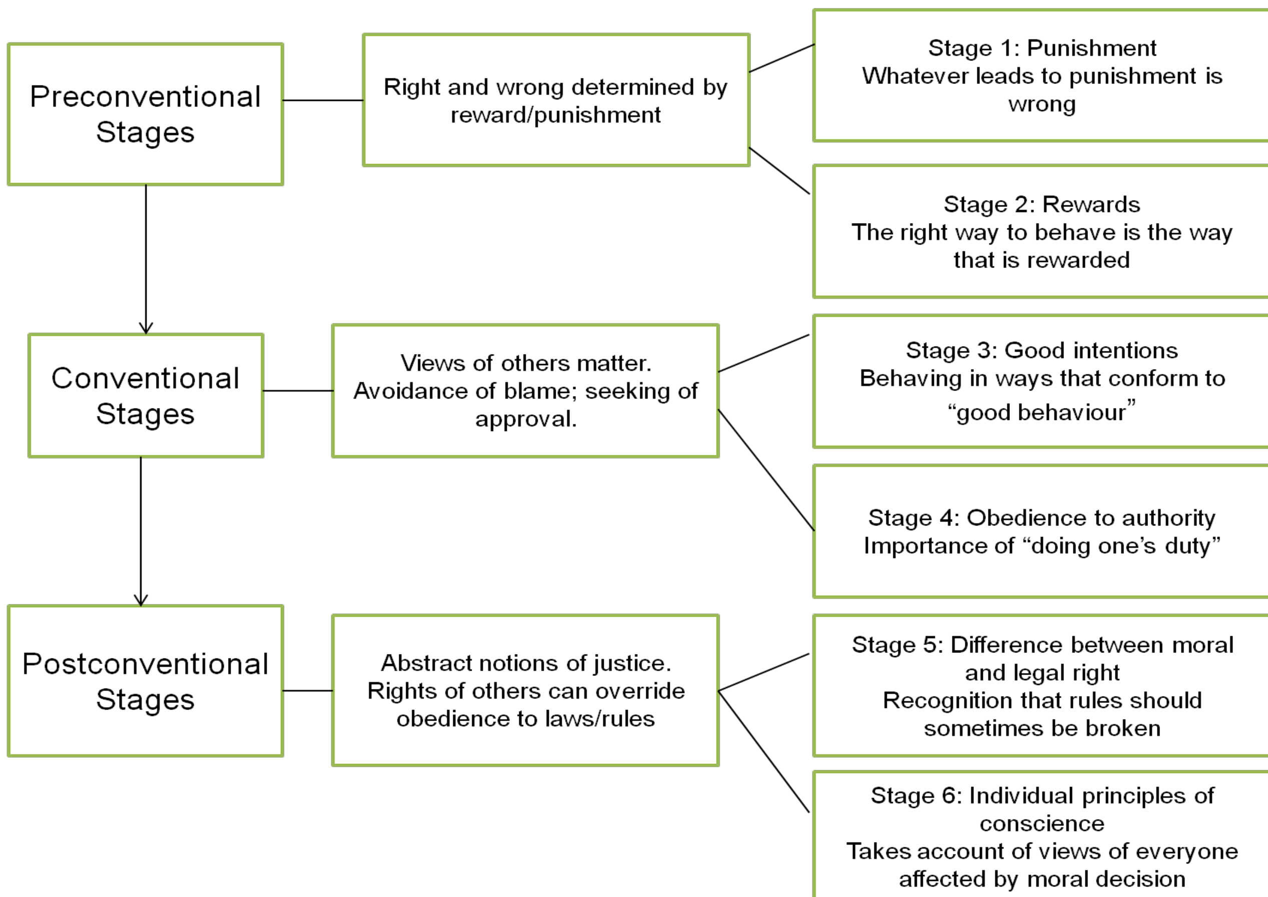
1. Using the articles above, evaluate the importance of business ethics from the perspective of maximising profit.
2. Critically assess the application of ethics in your business environment.
3. Based on perceived problems associated with business ethics, argue how these might be addressed when implementing ethical policies in your organisation.

7.1.4 Values

An understanding of business ethics is incomplete without an understanding of values. Values are the moral principles that an individual uses to guide his/her actions. Individual values are reflective of the moral principles that an individual considers to be important.

Moral principles can be understood in the context of an individual's stage of moral development:

Figure 1: Kohlberg's three stages of moral development



As the diagram above illustrates, Kohlberg hypothesised that an individual's morality develops through three stages: the preconventional stages, the conventional stages, and the postconventional stages.

Level One: Pre-conventional stages

This refers to the moral development of a very young child. It consists of two stages:

- Stage One: Punishment and Obedience Orientation
  - This stage is characterised by lacking an understanding that others have needs and wants.
  - The child only acts in the right way because she fears punishment or wishes to be obedient to their parents or guardians.

- Stage Two: Instrumental and Relative Orientation
  - The child acts in the right way towards others so that they will treat her in the same way.
  - The child becomes aware of the fact that others have needs and wants like herself.
  - Using this knowledge the child acts in a way that will ensure that she gets what she wants.

Level Two: Conventional Stages

These stages occur when the child is significantly older. Their morals begin to be influenced by their society, friends, family and nation.

- Stage Three: Interpersonal Concordance Orientation
  - During this stage the person follows the example set by people they respect in their peer group.
  - Correct action is based on how well it will be perceived by the people respected
  - So people act to impress so they will be considered good

- Stage Four: Law and Order Orientation
  - At this point the person is acting according to the rules and regulations of their society or nation.
  - The person identifies with a group or nation and understands that their individual actions affect the entire collective so they act with the group’s interests in mind.
  - She can also determine the difference between what she is obligated to do as a member of the group and what her individual obligations are.

Post-conventional Stages

It is at this point that a person no longer just simply takes the values and norms of their society as guidelines for their action. They use their own thinking processes to determine what the right course of action is.

- Stage Five: Social Contract Orientation
  - During this stage, the person comes to see that people possess different values but that there may be ways to reconcile all of these into one cohesive system.
  - The person believes that other moral views deserve equal space alongside their own.

- Stage Six: Universal Moral Principles Orientation
  - At this final stage of moral development, people come to see that the right way to act is based on the universality and consistency of values.
  - According to these universal values, the person then judges whether action is morally right or wrong.

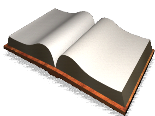
(Adapted from Velasquez, 2012:38-39)

The organisation has to take individual values into account in order to create a work environment in which people feel not only as if they are reaching their career goals, but as if their personal aspirations are being met. This means that organisational values need to be composed of the individual values of stakeholders in an organisation (Ferguson and Milliman, 2008:439).

Organisational values are important because the development and implementation of organisational values directly influences the extent to which an organisation will be ethical or not (Fry and Slocum, 2008:87).

Core organisational values

The values that an individual has after reaching the final stage of moral development contribute to the creation of an organisation's ethical system. Read more about organisational values in the following source:



Thomsen, S. 2004, 'Corporate values and corporate governance', *Corporate Governance*, 4 (4), 29-46, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=4&issue=4&articleid=873211&show=html (accessed 10 April 2014).

Task Questions

Thomsen (2004:30) writes, "If the firm as such is nothing but a legal fiction, its values must ultimately be derived from the preferences or values of its stakeholders. In other words, corporate values are created when companies internalize the values of salient stakeholders."

1. Critically evaluate Thomsen's model (page 30) of the creation of corporate values.
2. Apply this model to your own organisation to evaluate whether or not your business is living stakeholder values.

Ferguson and Milliman define core organisational values as what the organisation regards as important 'beliefs and ideas that intrinsically influence the attitudes and behaviours of employees to achieve institutional and greater societal goals as well as promote employee attainment of personal aspirations.' Values are seen as the 'soul' of the organisation. They can also reflect the spirituality of the organisation.

Organisational values may be differentiated between level values – relating to output and how work is done by employees (for example in interacting with customers) – and psychological values – focusing on the moral beliefs of employees (for example what employees believe is integral to the functioning of the organisation).

Organisational values have far reaching implications for the organisation. Values can:

- Guide the decisions that are made by the organisation;
- Encourage people to form connections with the organisation based on shared values, or
- Provide guidance on moral dilemmas for employees.

Core values also ensure stability, as they remain the same over time.

(Adapted from Ferguson and Milliman, 2008:441)

Successful organisational value programmes are dependent on good spiritual leadership.

Fry and Slocum (2008) use a key phrase in Patricia Aburdene's influential book Megatrends to make the point that: 'Spirituality is 'today's greatest megatrend' (Fry and Slocum, 2008:89).

According to Aburdene, spirituality has created a market place where consumers want leaders to be driven by positive values because they are fed up with numerous incidents of corruption, greed, nepotism and favouritism. Owners, shareholders and managers recognise the importance of creating workplace spirituality where the organisation's strategy, systems, culture and structures are premised on positive values. There is growing evidence to suggest that workplace spirituality has a very positive impact on workplace productivity and profits. When people feel as if their core positive values are being upheld by the organisation, they are more likely to want to work for it and commit themselves to working as hard as possible for it.

It is important to clarify that spirituality is differentiated from religion. We might understand spirituality by defining it broadly as 'the discovery of our authentic self without any trimmings or labels, which gives us a rich source of values and a deeper meaning to life, whatever our religion' (Shapiro and Shapiro, 2011).

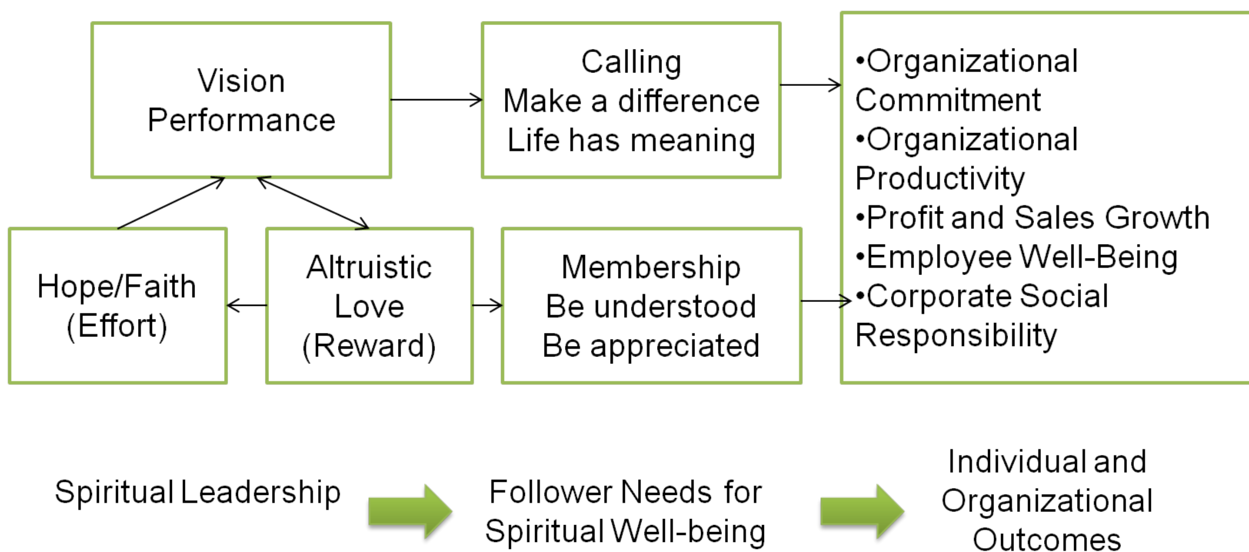
Similar to ethical leadership, spiritual leadership is concerned about promoting ethical behaviour in an organisation. However, spiritual leadership also attempts to improve organisational profits, productivity, commitment, employee well-being and corporate social responsibility.

As Ferguson and Milliman (2008) argue, spiritual leadership is the foundation for effective organisational values. This in turn enforces ethical behaviour. After all, ethics are informed by values. Being driven by a higher purpose and altruistic values defines spiritual leadership. Key facets of spiritual leadership are as follows:

- Creating a vision that appeals to both leaders and employees because it has meaning and relevance to everyone's lives; and
- Establishing an organisational culture based on the values of altruism.

(Adapted from Fry and Slocum, 2008:89)

Figure 2: Model of Spiritual Leadership



(Fry and Slocum, 2008:91)

The figure above demonstrates the outcome of spiritual leadership according to Fry and Slocum (2008:91). As you can see, the components of spiritual leadership (your vision, hope or faith, and altruism) satisfy the spiritual needs of the employee or stakeholder (desire for employees' lives to make an impact or difference and to be appreciated), which lead to the positive benefits for both the individual and the organisation (including fulfilling the requirements of corporate social responsibility).

According to Ferguson and Milliman (2008:445), spiritual leadership is 'key to effective organizational values programs because a true philosophical commitment is needed to articulate meaningful values, live one's values, and be committed to involving employees in value formation and practice.'

Read the articles below:

- Hyson, P. 2013, 'The spirited leader: the potential of spiritual intelligence to improve leadership', *The International Journal of Leadership in Public Services*, 9 (3/4), 109-115, http://www.emeraldinsight.com/journals.htm?issn=1747-9886&volume=9&issue=3/4&articleid=17102118&show=html (accessed 10 April 2014).
- McLaughlin, C. 2005, 'Spirituality and ethics in business', *European Business Review*, 17 (1), http://www.emeraldinsight.com/journals.htm?issn=0955-534X&volume=17&issue=1&articleid=1500660&show=html (accessed 10 April 2014).

Now answer the questions below:

Task Questions

1. Evaluate Hyson's argument regarding spiritual intelligence.
2. Evaluate the link McLaughlin makes between spirituality and ethics.

7.1.5 Conclusion

Ethical business practices are key in ensuring good corporate governance. Appreciating the role of ethics in a business setting is therefore important. However, while we have studied the meaning of business ethics in this section, we still need to explore its components – ie the practical parts of business ethics within your business. This is the focus of the next section of this Study Guide.

Recap Questions

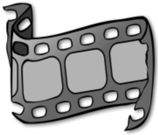
1. Explain the relationship between business ethics and corporate governance.
2. Define business ethics as it applies to your own organisation.
3. Evaluate the differences between ethics and business ethics.
4. Explain the purpose of business ethics and offer recommendations for how these purposes can be served in your own organisation.
5. Critically assess the role of individual values in the organisation.
6. Evaluate the potential of spiritual leadership in creating ethical businesses.
7. Examine whether or not there is there a distinction between spirituality and values.

7.2 Managing Ethics in Business

Timeframe:	Minimum of 40 hours
Learning outcomes:	• Critically examine terminology to understand how governance and control measures are applied in the business environment. • Critically analyse principles of ethics and ethical leadership by demonstrating a critical understanding of the importance of business ethics in a business environment. • Clarify the need for creating a common set of values within an organisational business ethics framework. • Critically examine how ethics impact upon business and profitability. • Understand your business in relation to the community's ethical framework including concepts of transparency, social responsibility, equity etc.
Recommended reading:	• Bushman, R.M. Piotroski, J.D. and Smith, A.B. 2003, 'What determines corporate transparency?' http://public.kenan-flagler.unc.edu/faculty/bushmanr/bushman_jar_transparency.pdf (accessed 10 April 2014). • KulshanCLT, 2013, 'Community Investing', http://www.kulshanclt.org/about-kulshanclt-homestead-version/ (accessed 7 April 2014). • Mohammed, M. 2013, 'Corporate accountability in the context of sustainability – a conceptual framework', *EuroMed Journal of Business*, 8 (3), 243-254, http://www.emeraldinsight.com/journals.htm?issn=1450-2194&volume=8&issue=3&articleid=17097063&show=html (accessed 10 April 2014). • Samsung Electronics, 2014, 'Corporate Citizenship,' http://www.samsung.com/za/aboutsamsung/samsungelectronics/corporatecitizenship/whatwecareabout.html (accessed 7 April 2014). • Starbucks, 2013, 'Being a Responsible Company', http://www.starbucks.com/responsibility (accessed 10 April 2014). • Virgin Media, 2012, 'Code of Conduct', http://investors.virginmedia.com/phoenix.zhtml?c=135485&p=irol-govconduct (accessed 10 April 2014).
Recommended Multimedia:	• Development Crossing, 2009, 'Did You Know? Corporate Social Responsibility', http://www.youtube.com/watch?v=GggyVO21hw8 (accessed 10 April 2014). • Fbucaro, 2011, 'The Importance of Ethics in Business' [video clip], http://www.youtube.com/watch?v=nJf3JhaiHtQ (accessed 10 April 2014). • Powell, C., Range, K. and Williams, J. 2009, 'Shell Oil in Nigeria' [slide show], http://www.slideshare.net/kran2796/shell-oil-in-nigeria-case-study (accessed 10 April 2014).
Section overview:	This section examines the types of ethical requirements businesses must observe to achieve good corporate governance. These are typically formed in response to the community's demands for corporations to be responsible and accountable. But how does the corporation balance these demands with profit? – This is explored in this section.

7.2.1 Introduction to Managing Ethics in Business

Watch the following video to understand ethics in the workplace:



Fbucaro, 2011, 'The Importance of Ethics in Business' [video clip], http://www.youtube.com/watch?v=nJf3JhaiHtQ (accessed 10 April 2014).

7.2.2 Control Measures

In countries with good legal systems, determining what ethical business practices are is a fairly easy task because the law delineates what is wrong and what is right. However, even in these cases it is necessary for a company to institute control measures to ensure that employees, stakeholders or board members do not commit unethical business practices.

Unethical behaviour

In the context of business, unethical behaviour refers to any activity that is branded as morally unacceptable by the society in which the corporation exists or by the corporation itself. Some examples of unethical behaviour include:

- Bribery and corruption (e.g. paying someone to give you a tender over another company);
- Nepotism (e.g. hiring a relative over other more qualified employees);
- Unfair employment practices (e.g. not hiring previously disadvantaged individuals);
- Fraud (e.g. deceiving creditors by creating false documents);
- Theft (e.g. stealing company property or other resources);
- Financial discrepancies (e.g. not reporting financial statements);
- Dishonesty (e.g. lying about the financial state of your company);
- Child or forced labour (e.g. employing underage employees or making people work for you without their consent);
- Plagiarism (e.g. stealing an idea from another company and passing it off as your own); and
- Restricting employees' rights (e.g. not allowing your employees to form labour unions).

Keep in mind that these are very general examples, and you should judge behaviour according to an appropriate analysis of the internal and external environment of the corporation, as well as a consideration of the legal requirements of your country.

7.2.3 Ethical controls

Ethical controls serve to guide ethical behaviour in organisations. Ethical control can occur at an individual and organisational level, which will be discussed in turn.

Locus of control

In addition to the controls a company puts in place, individual behaviour is influenced by a person's locus of control. According to Velasquez (2012:55) if a person believes that what is happening to him or her is within his or her control, then they have internal locus of control. If they believe that what happens to him or her is primarily the result of external forces such as powerful people, or luck, or circumstances, then they have external locus of control (Velasquez, 2012:55).

Those people who believe they are in control of their own lives (influenced by their internal locus of control) are more likely to follow their own ethical principles, while those who think that they are not in control over their lives (influenced by their external locus of control) are more likely to allow themselves to be misled into committing unethical acts (Velasquez, 2012:55-56).

Ethics control programmes

Control is one of the biggest responsibilities for the corporation. It covers both the ethical and legal requirements that the corporation must follow. Usually, a control system takes the form of an ethics programme (sometimes called a code of conduct). Formal ethics control programmes dictate and monitor the standard behaviour expected by all members of the corporation (Trevino and Weaver, 2003:90-91).

These programmes set out company values and expectations for ethical behaviour. These programmes typically include:

- An ethics code
    - States the corporation's expectations of ethical behaviour in accordance with its corporate governance policy.

- Ethics committees
    - Must create and develop the corporation's ethics policies
    - Monitor employee or company behaviour
    - Investigate or adjudicate ethical discrepancies or violations

- Ethics communication systems
    - Systems that allow and support whistle-blowers who report unethical behaviour
    - Systems providing guidance related to acceptable behaviour

- Ethics officers or ombudspersons
    - People who coordinate ethics policies
    - Those who provide advice or counselling on ethical dilemmas
    - Those who investigate allegations of unethical behaviour

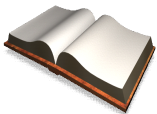
- Ethical processes
  (This part of the programme has several components)
  - Ethical performance appraisal (evaluation procedures to monitor ethical performance of the company)
  - Educating staff about corporate governance and ethical behaviour (informing employees about how they should act in relation to any and all ethical concerns)
  - Part of forming the strategic plan (when creating their strategy, businesses need to ensure that all of their plans are ethical and they should commit themselves to practising ethical procedures in their strategic plan)
  - Communicating the code to everyone who needs to know about it including employees, customers, suppliers and any other stakeholders.
  - Revising the code so that it is up-to-date and current.

- Disciplinary procedures
  - Instigated when behaviour infringes on the company's corporate governance programme, or is regarded as unethical.

- Ethical audits
  - Operated by an external third-party to ensure ethical behaviour is being properly monitored and effectively instituted in companies.

(Adapted from Trevino and Weaver, 2003:9)

For an example of a company's ethical programme, access the link below:



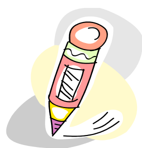
Virgin Media, 2012, 'Code of Conduct', http://investors.virginmedia.com/phoenix.zhtml?c=135485&p=irol-govconduct (accessed 10 April 2014).

Task Questions

1. Evaluate the strengths and weaknesses of Virgin Media's ethical programme.
2. Critically compare Virgin Media's ethical programme to that of your own business.
3. Evaluate the importance of an ethical code of conduct.

7.2.4 Transparency

A corporation must be transparent. In the context of business ethics, transparency refers to the accurate reporting of a company's operations, including its financial reporting. Some definitions of transparency are provided below:



'The extent to which investors have ready access to any required financial information about a company such as price levels, market depth and audited financial reports. Classically defined as when "much is known by many", transparency is one of the silent prerequisites of any free and efficient market. When transparency relates to information flow from the company to investors, it is also known as "full disclosure".'

(Investopedia, n.d.)

'The full, accurate, and timely disclosure of information. Transparency makes it more likely that assets will be accurately valued.'

(Business.yourdictionary.com, 2010)

'Organization specific information that is made available to the public. In publicly traded companies, corporate transparency is gauged by the amount of financial and corporate information to which the public has access.'

(Investorwords.com, 2013)

Transparency ensures that a community's ethical framework is upheld because it helps to prevent inaccurate reporting of a company's business dealings and the state of its finances, protecting both employees and investors while also guaranteeing that the corporation is acting ethically.

Financial transparency

Transparency refers to financial statements that are of an acceptable quality standard. Companies with higher quality financial statements are likely to have a higher market value as their business statements make sense to investors.

This is because the more information is available to investors, the more they can trust the company. Investors can have an adequate understanding of the risk associated with the company.

A lack of financial transparency can amount to:

- Fraudulent behaviour;
- False information;
- Making investments that aren't real;
- Plans designed to conceal something (i.e. multiple businesses in one), or
- Complex tax schemes.

Whichever form it takes, however, the fact remains that lack of transparency occurs whenever a company's ability to call on investors for valuable information is called into question. If investors cannot believe or understand financial statements, then the value of the company is void.

(Adapted from McClure, 2010)

Consider two companies with the same market capitalisation, same overall market-risk exposure, and the same financial leverage. Assume that both also have the same earnings, earnings growth rate and similar returns on capital. The difference is that Company A is a single-business company with easy-to-understand financial statements. Company B, by contrast, has numerous businesses and subsidiaries with complex financials.

Which one will have more value? Odds are good that the market will value Company A more highly. Because of its complex and opaque financial statements, Company B's value will be discounted.

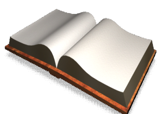
(McClure, 2010)

Corporate transparency is produced from a system that relates information to those inside the market, but outside of the corporation through the following methods:

- The corporate reporting regime;
- Private information acquisition; or
- Information dissemination.

(Adapted from Bushman, Piotroski and Smith, 2003)

Read the following source to learn about each of these methods:



Bushman, R.M. Piotroski, J.D. and Smith, A.B. 2003, 'What determines corporate transparency?' http://public.kenan-flagler.unc.edu/faculty/bushmanr/bushman_jar_transparency.pdf (accessed 10 April 2014).

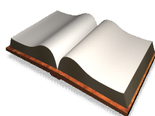
Task Questions
1. Apply the three methods of system regulation discussed above in order to determine how well your organisation complies with ethical transparency.

7.2.5 Corporate Social Responsibility

All corporations have obligations to the societies in which they are operating. Corporate Social Responsibility (CSR) refers to what these obligations entail (Velasquez, 2012:23). Corporate social responsibility is predicated on the concept of corporate accountability.

Accountability

Read the following article to understand accountability and its relationship with corporate social responsibility:

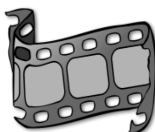


Mohammed, M. 2013, 'Corporate accountability in the context of sustainability – a conceptual framework', *EuroMed Journal of Business*, 8 (3), 243-254, http://www.emeraldinsight.com/journals.htm?issn=1450-2194&volume=8&issue=3&articleid=17097063&show=html (accessed 10 April 2014).

Task Questions

1. Mohammed (2013:244) argues that there is a lack of definition for corporate accountability. Evaluate this statement in light of accountability practices in your own business.
2. Explain the link between accountability and the responsibility a corporation has.
3. Critically assess the need for corporate accountability.

Watch the following clip to learn some facts about corporate social responsibility:



Development Crossing, 2009, 'Did You Know? Corporate Social Responsibility', http://www.youtube.com/watch?v=GggyVO21hw8 (accessed 10 April 2014).

Velasquez (2012) offers two distinct views of Corporate Social Responsibility:

- The Shareholder View

Milton Friedman was the first to advocate that the only responsibility a corporation has is to act legally and ethically in order to make as much money as possible for its shareholders. While there are legal and ethical limits to the way in which a company may act, Friedman believed that company executives must do whatever it takes to ensure the shareholders' interests above all else.

- The Stakeholder View

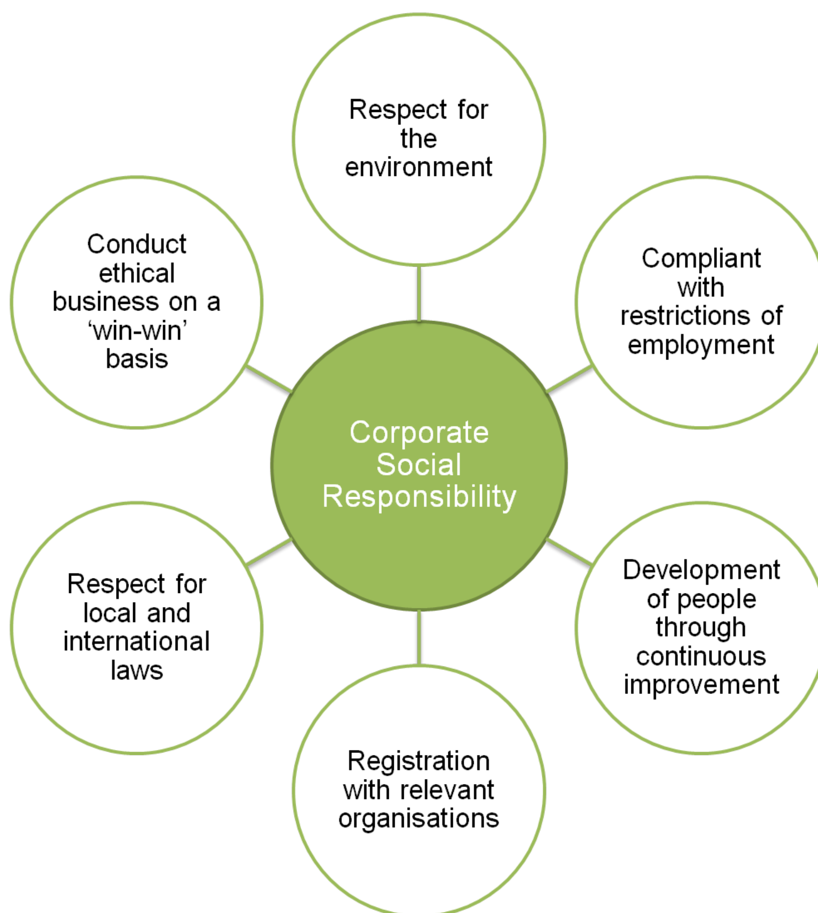
Opposed to Friedman's conception the stakeholder view advocates that the interests of all the stakeholders, and not just the shareholders, of a company must be considered in corporate governance. This means that when making decisions, all the stakeholders must be consulted. Although shareholders and stakeholders are often equated as being one and the same, in this context shareholder refers to those with equity in the company, while stakeholders refer to everyone associated with the company from the shareholders, to the board of directors, to the executives and to employees.

(Adapted from Velasquez, 2012:25-27)

The type of view that a company adopts will obviously influence their corporate governance policies. This is important for corporate social responsibility because the viewpoint adopted will determine the way in which the corporation responds to the needs both within and outside it.

The figure below highlights what these needs are:

Figure 3: Elements of Corporate Social Responsibility

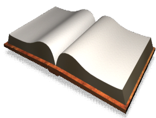


(Adapted from Hialtech.com)

As the figure shows, corporate social responsibility is complying with the following requirements:

- Making the company environmentally sustainable;
- Following the legal regulations of employment as stipulated by your country's labour laws;
- Ensuring people reach their potential by continuously developing them through skills and training programmes;
- Being accredited or registering with the appropriate bodies relevant to your organisation;
- Taking into account both local and international laws; and
- Conducting business ethically while ensuring business targets are met implying a win-win basis in which your organisation meets ethical requirements while also achieving business goals

For an example of a company's social responsibility agenda, access the link below to read Samsung's corporate social responsibility reports:



Samsung Electronics, 2014, 'Corporate Citizenship,' http://www.samsung.com/za/aboutsamsung/samsungelectronics/corporatecitizenship/whatwecareabout.html (accessed 7 April 2014).

Task Questions

1. Using the diagram above, consider how the view of corporate social responsibility that a business chooses to adopt would affect these elements.
2. Based on the different views of corporate social responsibility, which view do you think is the one which companies should adopt? Consider the dimension of business ethics in your answer.

Socially responsible investing involves meeting community demands to conform to expected standards of ethical business practices. This is because the rise in ethical concerns has meant that investors have started to stipulate environmental, social and corporate governance criteria in the management of private equity (Idinvest Partners, 2007:1).

This is evidenced by the emergence of:

- Demands for a cohesive investment strategy so that investing includes more than one asset class;
- Desires for certain shares to be included where investors have attachments to these shares;
- Increasing pressure to follow the United Nations initiative, "Principles for Responsible Investment"; and
- The fact that proposals often include corporate governance principles as a prerequisite demand.

(Adapted from: Idinvest Partners, 2007:1)

This is all motivated by "socially conscious investors" who 'want their financial capital to have a positive effect on the world and to generate optimal returns' (Einolf, 2007:72).

According to a report released by Idinvest Partners (2007:3), there are three components of building a socially responsible equity portfolio to meet these demands:

- The company products that are part of the portfolio influence economic activity through increasing sustainability;
- The economic impact of companies in the portfolios is targeted; and
- Management included in the portfolios meet sustainability requirements.

The results of socially responsible investing are termed "social returns." Social returns can vary from environmental, to religious, to value-based concerns. In this sense, socially responsible investing applies to:

- Environmentally-motivated investors (for example, those who base their investment decisions on choosing corporate policies that aim to lessen or eradicate damage to the natural environment);
- Religiously-motivated investors (for example, those who invest in companies that treat their employees with respect for their religious and spiritual beliefs); and
- Socially motivated investors (for example, those who require that company policy addresses social issues such as HIV/AIDS).

All three types of investors want social returns together with capital appreciation, even if their desire for social returns differs according to their motivation.

There are three types of socially responsible investing:

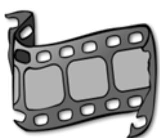
- Social screening;
- Shareholder advocacy; and
- Community investing.

(Adapted from Ciocchetti, 2007)

Environmental Ethics

Part of corporate social responsibility is to the environment, which has become a major concern for communities around the world with the rise in fears about global warming. There is increasing pressure on businesses to minimise hazards caused to the environment by corporate activities, e.g. hazardous dumping of waste.

Access the following slides and answer the questions, which follow:



Powell, C., Range, K. and Williams, J. 2009, 'Shell Oil in Nigeria' [slide show], http://www.slideshare.net/kran2796/shell-oil-in-nigeria-case-study (accessed 10 April 2014).

Task Questions

Using the slides and your own research, answer the following questions:

1. Evaluate the impact of Shell's activities on consumer behaviour.
2. Using the case of Shell, examine why environmental ethics should be a concern for your own business.
3. Choose a corporation whose environmental ethics stand out from the rest. Critically explain how their innovative environmental programmes have an impact on their profit margins.

Ethics and Employees

Around the world, businesses are employing more ethical employment practices. In many countries where previous discriminatory human resource practices have excluded certain demographics from job positions, there are affirmative action programmes in place to assert the rights of all races, both genders, and people with disabilities.

In addition, the corporation must seen to be caring for the individual employee – valuing their contribution to the running of the business.

7.2.6 The Impact of Ethics on Business and Profitability

As Velasquez (2012:18) notes, one of the objections to business ethics is based on the fact that organisations exist in order to make a profit and not to satisfy the ethical expectations of the community. However, socially responsible investing can increase profitability. Let us examine how this is accomplished through looking more closely at the types of socially responsible investment:

Social Screening

Social screening refers to the way in which investors either invest or divest in a company based on its track record of social responsibility.

It is based on the assumption that companies will do well or badly based on how well they perform according to social responsibility standards. It is divided into:

- Negative screening
- Positive screening

Negative screening happens when an investor divests stock based on their assessment of a company's social responsibility practices. For example, socially responsible investors screened-out South African companies in the 1980s because of apartheid (Buddle, 2008).

Positive screening occurs when an investor is attracted to a company based on its social responsibility practices. If a company is seen to have good social responsibility practices, it is theorised that it has a good strategy of corporate governance (Buddle, 2008). Positive screening thus increases a company's profit margins.

Shareholder Advocacy

There are three types of shareholder advocacy actions that can be followed:

- Discussions with management (the first step in approaching socially responsible ideas);
- Shareholder Resolutions (if discussions are unsuccessful, a proposal has to be made and submitted to management); and
- Boycotts (if discussions and the resolution process have failed, then consumers refuse to purchase a company's product or conduct business with the company).

By following ethical business practices, a company can avoid the negative impact caused by boycotts or strained relations with management.

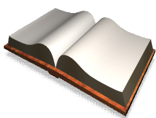
Community Investment

This is the process where investments are made in socially disadvantaged or impoverished communities where financial services have not been properly established. This type of investment aims to provide financial services that were previously unavailable in these communities. It involves giving communities these previously unavailable financial services such as banking, credit, equity, and healthcare.

But it can also include strengthening the community by building houses or creating employment opportunities. Alternatively, a company may also choose to invest in a community by providing educational opportunities.

An example of community investment is the American company KulshanCLT, which aims to provide mortgages for low-income families.

You can read more about KulshanCLT by accessing the link below:



KulshanCLT, 2013, 'Community Investing', http://www.kulshanclt.org/about-kulshanclt-homestead-version/ (accessed 7 April 2014).

Due to the fact that organisations produce what the community needs, critics of business ethics argue that by serving these needs the company is already fulfilling its responsibility to the market community.

Such an argument can be countered by considering some of the following points:

- Most competitive markets do not act in a perfect way (they can maximise profits even if production is inefficient);
- Some ways of maximising profits are harmful to the environment (e.g. pollution) or to the market community (e.g. fraud);
- The argument does not take into consideration the fact that not all members of the market community will have their needs satisfied by the sole pursuit of profit (e.g. people who lack the resources to purchase the organisation's goods); and
- Ironically, the argument itself assumes an ethical standpoint of its own by imposing one standard of behaviour on all managers (i.e. they all just want to pursue profit without considering anything else).

(Adapted from Velasquez, 2012:18)

Another common argument is called the "loyal agent's argument." The synopsis of this argument is that as a loyal worker for the employer, the manager has a duty to serve the employer's interests in whatever way will best achieve what the employer requires. This argument can be challenged in the following ways (Velasquez, 2012:19-20):

- It assumes a certain standpoint that is not based in proven considerations about the manager-employer relationship;
- The agent, while loyal to the corporation, is not expected to be bound to it (there are limits to this loyalty); and
- Being loyal is not equivalent to being brainwashed – the employer still has the capacity to choose between what is right and wrong.

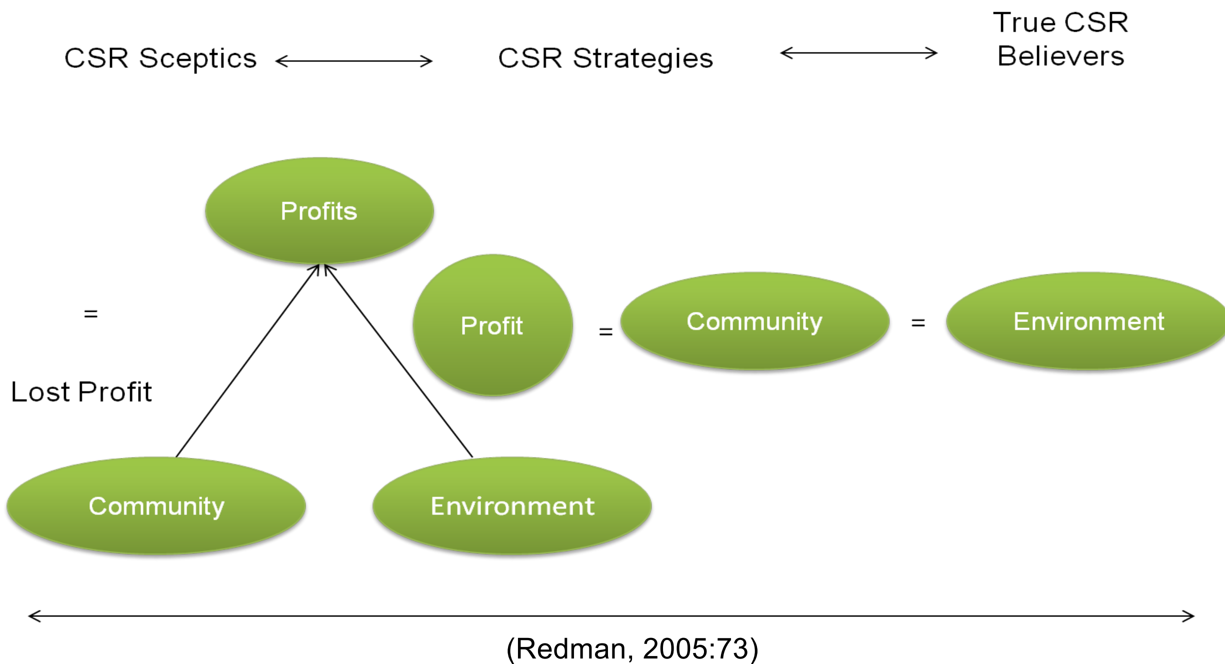
Another defence for pursuing profit without ethical considerations is that the law creates the rules and regulations that should determine business operations and therefore no other constraints should be placed on companies other than what is legally required of them.

However, while societal morality has infiltrated the law to an extent, especially when considering global legislation, we should consider that some laws might not completely satisfy all of our moral codes (Velasquez, 2012:20).

How then do businesses balance the clear objective of making a profit with the demands of ethics?

Elizabeth Redman (2005) identifies what she calls a 'corporate social responsibility continuum.' She argues that corporations do not have a rigid, unchanging policy balancing their ethics and their profits. Rather they have a perspective which is constantly shifting and which is influenced by the conflicting ideas of executives and company employees.

Figure 4: The CSR Continuum



(Redman, 2005:73)

This continuum shows how corporations do not exist as static entities with one unchanging strategic plan. Businesses are adaptable and make changes based on the demands of stakeholders and the internal and external corporate environments with a consideration of profit (Redman, 2005:73).

Your business may exist in any place along the continuum. In order to decipher your approach, Redman posits that it is necessary to determine corporate social responsibility according to the three following categories:

- CSR Sceptics;
- CSR Strategists; and
- CSR Believers

CSR Sceptics

The first category stipulates that corporate social responsibility inarguably reduces the profits of the firm. If corporations could pursue their business with no regard for the environment, this would undoubtedly maximise the corporation's profits. Corporate social responsibility and profits are seen as 'mutually exclusive objectives' (Redman, 2005:74).

CSR Strategists

This category falls in the middle of the corporate social responsibility continuum. Companies falling under this heading use corporate social responsibility as a business strategy in order to maximise profits. Using corporate social responsibility, companies can attract customers who prioritise ethical business practices as important when selecting which goods and services to choose.

Some corporations use corporate social responsibility as a marketing strategy to attract customers. Companies adjust their strategies according to the market needs of their customers, for instance if marketing research reveals that their customers are opposed to the poaching of rhinos, the company might become a large benefactor of a charity concerned with the preservation of the rhinos and advertise their contributions to appeal to customer concerns.

CSR Believers

Rather than pursuing corporate social responsibility objectives as part of business strategy, this category involves thinking that profit is not the only contribution that businesses make to society.

CSR believers are motivated by their adherence to the triple bottom line (social, environmental, and financial performance), so that financial outcomes are only one motivating factor for their actions. For these believers, corporate social responsibility is an ideological commitment equal to profit margins.

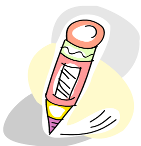
(Adapted from Redman, 2005:73-79)

The Triple Bottom Line

Instead of merely instituting the standard business model, organisations should create strategies that take into account ethical considerations. With the obvious objective of making a profit, business models should also consider the economic, social, and environmental factors influenced by their business plans. This is called 'the triple bottom line.'

(Adapted from Fry and Slocum, 2008:87-88)

The Triple Bottom Line approach was developed by the Institute of Social and Ethical Accountability. It states that corporations have a multitude of effects upon society, each causing a bottom line result (Jamili, 2006:812).



"TBL as it is evolving is a systematic approach to managing the complete set of a company's responsibilities. At its narrowest, the term is used to refer to a framework for measuring and reporting corporate performance against economic, social and environmental parameters. At its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to maximize the positive impacts of their activities and generate added economic, social and environmental value.

(Elkington, 1999)

The TBL approach therefore looks at how corporations manage and balance all three responsibilities (economic, environmental, and social) and attempts to reconcile these inter-related spheres of activity for a more balanced view of overall corporate performance (Sauvante, 2002; Panapanaan, 2002; McDonough and Braungart, 2002)."

(Jamili, 2006:812)

The triple bottom line is simplified into the three Ps: people, planet and profits. However, the problem is not defining the triple bottom line, but determining how to measure it (Slaper and Hall, 2011:4). This is because as Slaper and Hall (2011:4) state, measuring the economic, social and environmental impact of a company is not as straightforward as measuring company profits.

There is no standard method for measuring the triple bottom line. This means it is up to you as the manager to develop a system for determining how well your company is performing according to the three Ps.

You may choose to follow guidelines offered by Slaper and Hall (2011):

Economic Measures

Economic variables ought to be variables that deal with the bottom line and the flow of money. It could look at income or expenditures, taxes, business climate factors, employment, and business diversity factors. Specific examples include:

- Personal income;
- Cost of underemployment;
- Establishment churn;
- Establishment sizes;
- Job growth;
- Employment distribution by sector;
- Percentage of firms in each sector; and
- Revenue by sector contributing to gross state product.

Environmental Measures

Environmental variables should represent measurements of natural resources and reflect potential influences to its viability. It could incorporate air and water quality, energy consumption, natural resources, solid and toxic waste, and land use/land cover. Ideally, having long-range trends available for each of the environmental variables would help organizations identify the impacts a project or policy would have on the area. Specific examples include:

- Sulphur dioxide concentration;
- Concentration of nitrogen oxides;
- Selected priority pollutants;
- Excessive nutrients;
- Electricity consumption;
- Solid waste management;
- Hazardous waste management; and
- Change in land use/land cover.

Social Measures

Social variables refer to social dimensions of a community or region and could include measurements of education, equity and access to social resources, health and well-being, quality of life, and social capital. The examples listed below are a small snippet of potential variables:

- Unemployment rate;
- Female labour force participation rate;
- Median household income;
- Relative poverty;
- Percentage of population with a post-secondary degree or certificate;
- Average commute time;
- Violent crimes per capita; and
- Health-adjusted life expectancy.

Data for many of these measures are collected at the state and national levels, but are also available at the local or community level. Many are appropriate for a community to use when constructing a TBL. However, as the geographic scope and the nature of the project narrow, the set of appropriate measures can change. For local or community-based projects, the TBL measures of success are best determined locally.

There are several similar approaches to secure stakeholder participation and input in designing the TBL framework: developing a decision matrix to incorporate public preferences into project planning and decision-making, using a "narrative format" to solicit shareholder participation and comprehensive project evaluation, and having stakeholders rank and weigh components of a sustainability framework according to community priorities. For example, a community may consider an important measure of success for an entrepreneurial development program to be the number of woman-owned companies formed over a five-year time period. Ultimately, it will be the organization's responsibility to produce a final set of measures applicable to the task at hand.

(Slaper and Hall, 2011:4-5)

Task Questions

1. Using the arguments for and against ethics when measured against profitability, determine where your organisation is situated on the corporate social responsibility continuum and evaluate why this is the case.
2. Locate other businesses on this corporate social responsibility continuum, such as Starbucks, Nike, Apple and Microsoft.

7.2.7 Conclusion

Use the link below to explore Starbucks' ethical policies:

Starbucks, 2013, 'Being a Responsible Company', http://www.starbucks.com/responsibility (accessed 10 April 2014).

Using your reading, complete the recap questions below:

Recap Questions

1. Evaluate the following statements in relation to Starbucks' ethical policies: Making profit and being socially responsive are not necessarily incompatible objectives. There is compelling research that shows how businesses with a strong CSR focus are highly profitable.
2. Social responsibility should be a part of the business strategy. Assess the legitimacy of this statement.
3. Evaluate the importance of each area of Starbucks' responsibility programme (eg community, environment, etc).
4. Develop a plan for your own business that incorporates socially responsible behaviour with a consideration of profits.

7.3 Regulating Business Ethics and Corporate Governance in BRICS Countries

Timeframe:	Minimum 30 hours
Learning outcomes:	• Critically analyse accountability in terms of alignment with legislation, regulations and the codes relating to corporate governance and ethics by focusing on the roles and responsibilities of the directors, board committees, auditor and company secretary. • Demonstrate understanding of the legal duties of the directors by understanding and analysing their fiduciary duties and their duties of care and skill. • Apply the King III Code of Governance to a business environment in accordance with the King III Report recommendations.
Recommended reading:	• Ardichvili, A., Jondle, D., Kowske, B., Cornachione, E., Li, J. and Thakadipuram. 2010, 'Ethical Business Practices in BRICs: Comparing Perceptions of Managers and Employees in Brazil, Russia, India and China, and G7 Nations', Society for Business Ethics Annual Meeting', 2010, Center for Ethical Business Cultures, University of St. Thomas, http://www.cebcglobal.org/uploaded_files/Ethical_Business_Practices_in_BRICs.pdf (accessed 10 April 2014). • European Corporate Governance Institute, 2013, 'Index of Codes', http://www.ecgi.org/codes/all_codes.php (accessed 10 April 2014). • Saica. 2009, 'Summary of Report on Governance for South Africa – 2009 (King III)', http://www.mmbconsulting.co.za/images/KINGIII_SUMMARY_OF_REPORT_ON_GOVERNANCE_FOR_SOUTH_AFRICA.pdf (accessed 7 April 2014)
Recommended Multimedia:	• Maia, B. 'Corporate governance on BRICs: A mountain to climb' [video], http://www.youtube.com/watch?v=dyn9UwNo820 (accessed 10 April 2014).
Section overview:	Each BRICS nation has guidelines for corporate governance and business ethics best practice. In South Africa, the King Reports have set out the way in which corporate governance should be instituted since 1994. The King III Report is studied here in detail, while you are encouraged to do your own research into corporate governance in other BRICS nations to critically compare the guidelines of different developing countries. Likewise, a detailed breakdown of South African company legislation – integral for an understanding of corporate governance – is also provided, while you should conduct your own research into legislation in other BRICS countries.

7.3.1 Introduction to Context

Corporate governance and business ethics are not always governed by legislation. While there are legal limits to the actions of business executives (for example, against fraudulent business exchanges), ethical business practices are often a matter of principle rather than law.

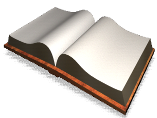
However, countries in the BRICS group do have guidelines that stipulate minimum ethical requirements companies should follow. Furthermore, the legal constitution of a company – ensuring good governance – is also regulated by legislation.

7.3.2 BRIC Nations

BRIC originally referred to the fastest growing developing economies – Brazil, Russia, India and China. Understanding the governance and ethical standards in these countries is important, for as Ardichvili, Jondle, Kowske, Cornachione, Li and Thakadipuram, 2010:2) write, the emergence of the BRICS nations as economic power houses necessitates an understanding of how business ethics and corporate governance is developing in these countries.

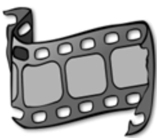
Corporate governance in BRIC nations

Using the index provided below, locate the relevant corporate governance policies for each BRIC country:



European Corporate Governance Institute, 2013, 'Index of Codes', http://www.ecgi.org/codes/all_codes.php , (accessed 10 April 2014).

The following video provides an introduction to the problems relating to corporate governance faced by the BRIC countries:



Maia, B. 'Corporate governance on BRICs: A mountain to climb' [video], http://www.youtube.com/watch?v=dyn9UwNo820 , (accessed 10 April 2014).

Task Question

Using the video above and your own further research into the BRIC nations, answer the task question below:

1. Evaluate the challenges faced by each BRIC nation in relation to corporate governance.

Business ethics in BRICS nations

The article below offers a comparative overview of business ethics in these countries, as well as how they compare to developed economies:

- Ardichvili, A., Jondle, D., Kowske, B., Cornachione, E., Li, J. and Thakadipuram. 2010, 'Ethical Business Practices in BRICs: Comparing Perceptions of Managers and Employees in Brazil, Russia, India and China, and G7 Nations', Society for Business Ethics Annual Meeting', 2010, Center for Ethical Business Cultures, University of St. Thomas, http://www.cebcglobal.org/uploaded_files/Ethical_Business_Practices_in_BRICs.pdf , (accessed 10 April 2014).

Using the articles above and your own further research into the BRIC nations, answer the task question below:

	Task Questions
Using the article above and your own further research into the BRIC nations, answer the task question below: 1. Critically compare the approach to business ethics in the BRIC countries.	

7.3.3 South Africa

In 2010, after a successful application to the BRIC group, South Africa became a member of BRICS – the 'S' now connoting South Africa's addition to the group. In South Africa, corporate governance and business ethics is mandated by the findings of the King III Report.

The King Reports have set out corporate governance best practice recommendations and although they do not constitute law, they provide a set of guidelines to ensure effective corporate governance by setting a benchmark standard of best practice. Corporate governance is also regulated by legislation.

Before attempting to define and understand aspects of corporate governance, it is important to briefly discuss the various King Reports that have been developed in South Africa.

In South Africa corporate scandals such as Masterbond and Leisurenet in the late eighties revealed the need for corporate governance regulation. Global collapse had produced corporate regulatory codes in the UK and in the USA. In the UK, the Cadbury Report had focused on guidelines for financial control. In the USA, the Treadway Commission published regulatory guidelines. In South Africa, consistent with international best practice, King I was published in 1994 and included a Code of Corporate Practices and Conduct the King report on Corporate Governance (King I). This was the first governance code in South Africa and it aimed to provide guidelines for organisations in both public and private sectors to achieve good corporate governance. King I, II and III were named after the former High Court judge, Mervyn King who chaired the committees responsible for research and the actual compilation of the documents.

The King I Report

Corporate governance in South Africa was institutionalised by the publication of the first King Report on Corporate Governance in 1994. The King Committee was formed in 1992 under the auspices of the Institute of Directors. The purpose of the King Report was to promote good standards of corporate governance. The King Report of 1994 not only provided guidelines on financial and regulatory matters, but also advocated an inclusive approach to corporate governance.

An inclusive approach to corporate governance stipulates that directors should use the triple-bottom line management approach.

The King II Report

Another King Report was issued in 2002 (King II). In King II the seven characteristics of good governance are listed. They are:

- Discipline (a commitment by the company management to adhere to behaviour that is universally accepted);
- Transparency (the ease with which an outsider is able to make meaningful analysis of a company's accounts);
- Independence (the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interests);
- Accountability (individuals in a company should be accountable for the actions they take);
- Responsibility (this pertains to behaviour that allows for corrective action and or for penalising mismanagement);
- Fairness (the systems that exist in a company must be balanced in taking into account all those that have an interest in the company and its future); and
- Social responsibility (a well-managed company will be aware of social issues and respond thereto).

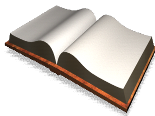
The King II contains a Code of Corporate Practices and Conduct. This Code is applicable to:

- All companies listed on the JSE Limited;
- Banks, financial and insurance entities as defined in the applicable legislation; and
- Public sector enterprises and agencies.

All other enterprises should also give due consideration to the provisions of the Code. It is important to note that the provisions in the Code are only recommendations and compliance is thus voluntary. The Code should not be regarded as a set of detailed rules on directors' conduct. The Code operates on a "comply or explain" basis. If the enterprises listed above do not comply with the Code they need to explain their reasons.

The next section provides some of the most important recommendations on corporate governance. Boards of directors, directors, auditors and the company secretary are focused on.

The following are important recommendations concerning directors and the board of directors as contained in King II:



- Every board should have a charter setting out its responsibilities.
- The board should determine the company's purpose, values and stake holders relevant to the business of the company.
- The board must monitor management in the carrying out of board plans and strategies.
- The board should comprise of a balance of executive and non-executive directors. The majority should preferably be non-executive directors.

Executive Director: An individual involved in the day-to-day management of the company or in the full-time salaried employment of the company.

Non-Executive Director: An individual not involved in the day to day management of the company and not a full time employee receiving a salary. A non-executive director should have the necessary skills and credibility to bring judgment independent to those of the executive directors to the board. Non-executive directors should limit the number of other appointments in order to be as independent as possible.

- The board must find the correct balance between conforming to governance constraints and performing in an entrepreneurial manner. "Box ticking" should be avoided at all costs. Box-ticking refers to the situation where corporate governance boxes are ticked, indicating that there was compliance with a specific aspect. It is, however, important that there is substantive compliance with the rule and not just with the form.
- The chairperson of the board should preferably be a non-executive director.
- The board should appraise the performance of the chairperson on an annual basis.
- The Chief Executive Officer and the chairperson should not be the same person.
- Companies should appoint a remuneration committee to make recommendations to the board concerning the remuneration of executive directors. This committee should mainly or entirely consist of non-executive directors.
- Companies should provide full disclosure of directors' remuneration on an individual basis.
- The board should ensure that processes are in place to assess risks facing the company. The assessment should address, for example, physical and operation risks, human resource risks and technology risks. Companies should appoint a risk management committee to assist the board in reviewing the risk management process and significant risks facing the company.

In the words of the King II (2002:70):

"… successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company."

King II (2002:78) also emphasised the importance of both financial and non financial aspects of governance.

"Many drivers of future value in a business context are non-financial. In evaluating a company's worth and potential as an investment vehicle, analysts focus on many issues, of which the following represent merely a sample:

- Market position (i.e. where the business stands in relation to its competitors)
- Political situation
- Quality of corporate strategy
- Quality of major business processes
- Understanding of key business risks
- Strength and quality of business processes
- Understanding of key business risks
- Strength and quality of risk management practices
- Standing, experience and credibility (trustworthiness) of management
- The nature and extent of management succession planning
- Client base (i.e. quality of clients)
- Brand strength (i.e. the image of the business and how it is perceived by the market)
- Employee relations
- Ability to attract and retain talented staff
- Innovation (new techniques or products) research and development capabilities
- Intellectual capital (i.e. the intellectual capital of employees)
- Supply chain quality and reliability
- Global reach and capacity (i.e. the geographical area covered by the business)
- Level and extent of executive remuneration"

The King III Report

The third King report became effective in March 2010 after it became necessary to make changes due to the introduction of the new Companies Act.

King III applies to all corporate entities, including both private and state-owned companies described as 'SOC Limited.'

The King III Report considers the following components of corporate governance:

- Boards and directors;
- Corporate citizenship;
- Audit committees;
- Risk management;
- Internal audits;
- Integrated sustainability reporting;
- Compliance with laws, regulations, rules and standards;
- Managing stakeholder relationships; and
- Fundamental and affected transactions and business rescue.

Like its predecessors, the report offers recommendations that companies can follow and it is not set in stone. However, if companies deviate from the report's recommendations, they are expected to justify their reasons for doing so. The report is based on maintaining the highest standards of corporate governance.

It states the following codes of business practice:

Boards and directors:

- The directorate should be composed of a majority of non-executive directors who are also independent.
- There should be at least two executive directors (the CEO and the financial head) on the board.
- A non-executive, independent chairperson should lead the board.

Remuneration of directors:

- Shareholders must approve the remuneration policy.
- A remuneration policy must be produced each year.
- Directors and the chairperson must not receive payments that are related to the share price.

Risk management:

Risk management is a fundamental part of a business's strategy and it cannot be separated from the business plan.

Mergers, acquisitions and take-overs:

Included for the first time in the Code due to changes in the Companies Act.

(Adapted from Visser, 2009)

In the introduction to the Code of Good Governance Principles for South Africa, the following important statements are made about King III:

"The Code has endeavoured, as with King I and King II, to be at the forefront of governance internationally. The focus of King III is on integrated reporting and the importance of reporting annually on:

- How a company has both positively and negatively affected the economic life of the community in which it operated during the year under review.
- How the company intends to enhance those positive aspects and eradicate or ameliorate the negative aspects on the economic life of the community in which it will operate in the year ahead."

(King III, 2009)

King III expressly applies to all entities regardless of the manner and form of incorporation or registration, and therefore applies to all organisations in both public and private sectors in South Africa.

The questions that now remain are, to what extent will King III be "applied or explained" by the public sector, and will it happen in conjunction with its private sector counterparts? This issue is all the more relevant because the adoption of the "King Code of Corporate Practices and Conduct 2002." (King II) has been limited in the public sector. This is largely due to the requirement of compliance with the Public Finance Management Act (PFMA), Act no. 1 of 1999, and the Municipal Finance Management Act (MFMA), Act no. 56 of 2003, regulating financial management in the public sector. Therefore the focus of governance in the Public sector has essentially been primarily on financial management and control.

The application of King III will encourage and develop a more holistic approach towards corporate governance in the public sector. The King reports stress the triple bottom line, which is profits, people and planet, which must be reported and disclosed to stakeholders through integrated reporting.

The public sector consists of national, provincial and local government spheres, plus various trading and public entities as well as state-owned enterprises. These state-owned enterprises (SOEs), as defined in the PFMA and MFMA, also fall under the ambit of the new Companies Act.

Relevance of the Code to state-owned enterprises, or, as King III refers to them, state owned companies (SOC Limited), is apparent due to their legal status and similarity in structure to other public and privately owned companies. Consequently, the composition of the SOC board as well as its role and responsibilities, as defined by King III, can easily be applied. The more difficult question relates to the relevance and application of King III to national and provincial departments and local authorities and their related entities.

In May 2007, National Treasury published the Framework for Managing Programme Performance Information (Framework) to provide guidance on matters of performance management as prescribed by the PFMA and MFMA.

In its introduction, the Framework states:

"Performance information indicates how well an institution is meeting its aims and objectives, and which policies and processes are working. Performance information is key to effective management, including planning, budgeting, and implementation, monitoring and reporting. Performance information also facilitates effective accountability, enabling legislators, members of the public and other interested parties to track progress, identify the scope for improvement and better understand the issues involved. The public sector delivers services essential to the well-being and development of the nation. To ensure that public service delivery is as efficient and economical as possible, all government institutions are required to formulate strategic plans, allocate resources to the implementation of those plans, and monitor and report the results."

This is not unlike the private sector where shareholders expect to receive reliable and trustworthy information from the organisation. It is safe to say that good corporate governance in both sectors is a prerequisite cornerstone of good performance and adequate reporting of such performance. Consequently, the South African public, whether as taxpayers, consumers, service providers or recipients of government benefits, and foreign entities interacting with South Africa, are all stakeholders in the South African government.

As they all have a vested interest in the success of the government enterprise, it is no surprise that they demand that good corporate governance principles are applied beyond mere legislative compliance. Application of the PFMA, MFMA and other legislation as a minimum requirement is therefore no longer sufficient in a global environment where stakeholders require increased transparency. Rating agencies are extending their assessment to include the governance practices of both private and public entities. As an increasing number of public entities are using these agencies' ratings to negotiate the cost of borrowing, particularly given the increased government investment in infrastructure, sound governance practices are becoming an imperative and not a choice.

When it comes to implementing King III and the Code, application of each principle should be assessed in terms of its contribution towards fulfilling this commitment to service delivery. This is particularly important considering the principles of Batho Pele, and that government's core function is to be responsible to society and to deliver on mandates such as:

- Building sustainable and cohesive communities;
- Creating decent employment and sustainable livelihoods;
- Intensifying the fight against crime and corruption;
- Providing basic healthcare for all;
- Making education a priority;
- Furthering rural and agricultural development;
- Land reform; and
- Making certain of food security and ensuring that no one goes hungry.

It is against this background and in the context of the philosophy of the King III report, which revolves around the principles of leadership, sustainability and corporate citizenship, that the relevance and benefits of applying the principles of King III can be appreciated.

These principles may be explained as follows:

- Good governance is essentially about **effective leadership**. Leaders need to rise to these challenges if there is to be any chance of effective responses. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour with regard to sustainability performance.

- "**Sustainability** is the primary moral and economic imperative for the 21st century, and it is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that need to be understood by decision makers. Most importantly, current, incremental changes towards sustainability are not sufficient - we need a fundamental shift in the way companies and directors act and organise themselves.

- "**Innovation, fairness, and collaboration** are key aspects of any transition to sustainability. Innovation provides new ways of doing things, including profitable responses to sustainability; fairness is vital because social injustice is unsustainable; and collaboration is often a prerequisite for larger scale change.

- "The legacy of apartheid is fundamentally unsustainable - social transformation and redress is therefore an important aspect and needs to be integrated within the broader transition to sustainability. **Integrating sustainability and social transformation** in a strategic and coherent manner will give rise to greater opportunities, efficiencies, and benefits, for both the company and society, than the fragmented and at times contradictory approach currently adopted by many companies.

- "King II explicitly required companies to implement the practice of sustainability reporting as a core aspect of corporate governance. Since 2002, sustainability reporting has become a widely accepted practice and South Africa is an emerging market leader in the field (partially due to King II). However, **sustainability reporting is in need of renewal** in order to respond to the lingering distrust among civil society of the intentions and practices of big business; and concerns among business decision makers that sustainability reporting is not fulfilling their expectations in a cost effective manner."

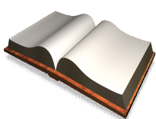
Although the language and terminology of King III appears to focus largely on companies and their related structures, this misconception is expressly dispelled: "Although the terms 'company', 'boards' and 'directors' are used, in this Code and the Report refer to the functional responsibility of those charged with governance in any entity and should be adopted as appropriate." (King III, 2009:19).

By implication, these principles are applicable to the public sector and would greatly contribute to improving public sector governance and applying the Batho Pele principles.

In addition, it is necessary to understand that company law has been significantly changed by the latest company legislation in South Africa. The latest Companies Act 71 of 2008 has largely reformed and essentially repealed the Companies Act 71 of 1973 to improve transparency and standards of corporate governance. The latest Companies Act became operational on 1 May 2011.

King III is therefore concerned with creating and sustaining ethical business practices in South African companies.

To read about the King Report in more detail, access the following link:



Saica. 2009, 'Summary of Report on Governance for South Africa – 2009 (King III)', http://www.mmbconsulting.co.za/images/KINGIII_SUMMARY_OF_REPORT_ON_GOVERNANCE_FOR_SOUTH_AFRICA.pdf (accessed 7 April 2014).

Task Questions

1. Assess why it was necessary to introduce a new King code by comparing the King III with its predecessors.
2. Evaluate the extent to which your own business follows the King III Report.
3. Critically compare King III with the corporate governance policies of the other BRICS countries.

Separate Legal Personality

It is essential that you understand the effect of this company law principle, which essentially states that a company's existence is separate to the humans; i.e. the shareholders and directors that perform its business. This may seem strange, particularly in a small company where the two shareholders are also its directors. Even though the company is made of bricks and relies on the shareholders to register it and on the directors to contract on its behalf, the law separates the existence of the company from the shareholders. This is done in law, by treating the role of the shareholder as separate from the role as the director. This means that the two individual directors will wear different hats or different capacities; i.e. the role of shareholder and the role of director will carry different rights and responsibilities.

How does a legal person or subject come into existence? The law recognises both natural and juristic persons as legal subjects that are capable of bearing rights and duties. A legal or juristic person like a company or a state entity e.g. ESKOM will derive its existence from specific legislation or from the company registration process which is set out in the Companies Act.

Natural persons like you and I acquired legal personality on the day we were born, evidenced by the birth certificate. Similar to the natural person, a company is "born" and becomes a person in law when it is formally registered or incorporated. To evidence the fact that the company is a legal entity the Companies office issues a Certificate of incorporation, which describes the date when the company was registered and became a legal personality. A legal person or legal personality acquires the ability to have rights and duties from the day the person is born or the date that the entity is registered. In law, a company exists as a separate legal person on its own.

Therefore, the company acquires the capacity to have its own rights and duties. Another way of saying this is to say that a veil or curtain of incorporation gets drawn to separate the existence of the company from its shareholders. The consequence of separate legal personality is limited liability, which means that if the company is unable to pay its debts to its creditors, the creditors cannot sue and claim from the shareholders i.e. the claim of the creditor is limited to only claim from the company. This means that the company is separate and distinct from its shareholders, directors, managers and employees. The profits of the company belong to the company and, shareholders are only entitled to receive dividend payments determined by the rights attached to the class of shares they own and should the company authorise payment of the dividend. The principle of separate legal personality has in certain exceptional instances being disregarded by the courts and shareholders have incurred personal liability, but this has generally only arisen in exceptional circumstances, for example in circumstances of fraud.

Understanding separate legal personality and consequent limited liability, is essential to understanding corporate governance. Broadly speaking, corporate governance refers to the internal systems of control within a company, which ensure that companies are effectively protected and ethically directed and controlled by the human controllers. You need to understand that a company is dependent upon its directors and managers to best manage its affairs. Since the company is regarded in law as separate from the shareholders and directors, corporate governance essentially aims to protect the profits and assets of the company from the abuse of these controllers i.e. directors and managers, to ensure that the best interests of the company and its stakeholders are protected.

Types of Companies

Now that we have discussed the legal nature of a company, it is important to consider the different types of companies that may be registered to carry on business in South Africa. The latest Company Act has created new categories of companies. The South African economy consists of companies that were incorporated or registered before the latest Companies Act and the new categories of companies registered since the latest Companies Act came into effect on 1 May 2011.

Companies are formed either to carry on business for profit or not for profit. Two types of companies are formed and incorporated under the latest Companies Act, namely profit and non-profit companies.

Types of profit companies:

- State-owned company;
- Private company;
- Personal liability company; and
- Public company.

Formation and Incorporation of Companies

The process of forming a company requires the type of company selected to be described in documentation known as the Memorandum of Incorporation ("MOI"). The MOI is the constitution of the company that describes the scope of its business and the internal controls. Registration of a company requires the completion and signing of the MOI and this document is accompanied by a prescribed notice of incorporation ("NOI"). These documents must be submitted to the Companies and Intellectual Property Commission ("CIPC") for approval before the company will be registered.

A company is deemed to be a legal or juristic person from the date that it is registered in terms of section 19 of the Companies Act. Once the company is registered the CIPC will issue a certificate to evidence registration and will allocate a registration number to the company. The certificate is evidence that the requirements for incorporation have been met and that the company is a lawful registered entity.

Task Questions

1. Why is an understanding of separate legal personality necessary when considering corporate governance?
2. Explain the steps to register a company in South Africa.
3. Create a diagram to describe the categories of companies in terms of the latest Companies Act.
4. Briefly explain the essential characteristics of each of the following types of companies:
    a. Private company
    b. Public company
    c. State-owned company
    d. Non-profit company
    e. Personal liability company

Roles and Responsibilities of Directors

In South Africa, companies are composed of two main parts:

- The shareholders; and
- The board of directors.

The board of directors is responsible for the management functions of the company and as such they are key in implementing good governance throughout the company. Once a company is a registered entity, the board of directors assumes various responsibilities in order to maintain the company's ethical and legal obligations.

They include:

- Oversight of control and accountability;
- Creation of strategy and objectives;
- Implementing risk management and other methods of control to meet legal and ethical requirements;
- Keeping track of senior management performance;
- Ensuring the availability of resources;
- Monitoring finances;
- Making board appointments and ensuring appropriate remuneration; and
- Statutory duties required by the Companies Act.

(Adapted from Law24.com, 2013)

The duties of directors as required by the Companies Act are explained below:

The Board of Directors

The Act provides for the business and affairs of a company to be managed by, or under, the direction of its board. The board has the authority to perform any of the functions of the company except to the extent that the Companies Act or Memorandum of Incorporation provides otherwise.

A private company or personal liability company requires at least one director, whilst a public company or a non-profit company requires at least three directors. These minimum numbers may be increased in a company's Memorandum of Incorporation. Should a company at any time fail to have the requisite minimum number of directors, the authority of the board will not be limited or negated, neither will anything done by the board or the company be invalidated.

The Memorandum of Incorporation may also provide for:

1. The direct appointment or removal of one or more directors by any person who is named in, or determined, in terms of the Memorandum of Incorporation
2. A person to be an ex officio director as a consequence of holding an office, title, designation or similar status
3. The appointment or election of alternate directors
4. Shareholders of profit companies (other than state-owned entities) to elect at least 50% of directors and at least 50% of any alternate directors.

The first directors of a company are the incorporators. The board may comprise directors that are permanent, alternate, temporary or ex officio, all with common duties and liabilities.

A person becomes a director of a company when that person has been appointed or elected or holds an office, title, designation or similar status entitling that person to serve as a director and has all the powers, functions and duties of any director, and is subject to all of the liabilities of any director. The Memorandum of Incorporation may limit the powers and functions of the ex officio director, but not the duties and liabilities.

Directors may be remunerated for their services unless provided otherwise in the Memorandum of Incorporation. However, remuneration may only be paid in accordance with a special resolution approved by the shareholders within the previous two years. The practicality of this clause may certainly prove a challenge and will undoubtedly serve as yet another reason to make the position of a South African director rather unattractive.

A director may be appointed for an indefinite term unless otherwise stipulated in the Memorandum of Incorporation. An indefinite term of office really does go against basic corporate governance principles, so hopefully this provision is excluded from the final Act. Unless the Memorandum of Incorporation provides otherwise, a board may also appoint a director on a temporary basis and such temporary director will have all the powers, functions and duties of a director and be subject to all of the liabilities of any other director of the company.

The Act also provides for the Minister to appoint a 'prescribed officer' within a company.
Provisions for filling vacancies on a board, and removal of directors, are also dealt with and it is a requirement that within ten business days after a person ceases to be a director, a company must file a notice in that regard.

Who may not be a director?

Juristic persons, unemancipated minors (or persons under similar legal disability) or anyone who does not satisfy any qualification set out in the Memorandum of Incorporation are ineligible to be a director.

Unless exempt by a court on application, you may not be a director, ex officio director, alternate director, temporary director or prescribed officer if:

- A court has prohibited you from accepting a directorship position
- You are an unrehabilitated insolvent
- You are prohibited in terms of any public regulation to be a director of the company
- You have been removed from an office of trust on the grounds of misconduct, involving dishonesty
- You have been convicted in the Republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence (involving fraud, misrepresentation or dishonesty, in connection with the promotion, formation or management of a company, or in connection with ineligibility or disqualification to serve as a director or probation in terms of a court order).

The last grounds for disqualification mentioned above prevail for a period of five years from the date of removal from office or completion of the sentence imposed, however, it may be extended for a further five year period if a court believes it is in the interests of protecting the public, on application by the Companies Commission.

Exception to the rule

Despite being disqualified, a person may act as a director of a private company if all the shares of that company are held by that disqualified person alone, and persons related to that disqualified person and each such person has consented in writing to that person being a director of the company. The Companies Commission is empowered to establish and maintain a public register of persons who are disqualified from serving as a director, and who are subject to an order of probation as a director. This register will clearly be cause for concern from a human rights perspective.

Duty to disclose a conflict of interest

The requirement and process to be followed in respect of disclosure of interest is clearly set out in the Act. In terms of Section 75, if a director of a company has a personal financial interest in respect of a matter to be considered by the board, or knows that a related person has a personal financial interest in the matter, the director:

1. Must disclose the interest and its general nature before the matter is considered at the meeting
2. Must disclose to the meeting any material information relating to the matter, and known to the director
3. May disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors
4. If present at the meeting, must leave the meeting immediately after making the disclosure
5. Must not take part in the consideration of the matter except to the extent of being requested to disclose observations by the other directors

While the director is required to recuse himself, he is to be regarded as present for the purposes of constituting a quorum and is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted and must not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board.

If a director acquires a personal financial interest in an agreement or matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest in the matter after the agreement or other matter has been approved by the company, the director must promptly disclose to the board the nature and extent of that interest and the material circumstances relating to the director or related person's acquisition of that interest.

A decision by the board or a transaction or agreement approved by the board or company is valid despite any personal financial interest of a director or person related to a director if it was approved in the manner explained above, or has been ratified by an ordinary resolution of the shareholders. Any interested person may apply to court to have a transaction or agreement approved by the board or shareholders declared valid, as the case may be, despite the failure of the director to satisfy the requirements explained above.

Standards of conduct

The Companies Act No 71 of 2008 includes a detailed section on the standards of directors' conduct and codifies the common law relating to directors' duties as well. It precludes an abuse of power in that a director must not use his position, or any information obtained while acting in the capacity of director, to gain an advantage personally, or for another person, other than the company or a wholly owned subsidiary of the company; or to knowingly cause harm to the company or a subsidiary of the company. Furthermore, the director must communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director reasonably believes that the information is immaterial to the company or generally available to the public, or known to the other directors; or is bound not to disclose that information by a legal or ethical obligation of confidentiality.

Act in the best interests of the company with the requisite care, skill and diligence

A director is required to exercise his powers and perform his functions as director in good faith and for proper purpose, in the best interests of the company and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director, and having the general knowledge, skill and experience of that director.

A director would be considered to be acting in the best interests of the company with the requisite degree of care, skill and diligence if he had taken reasonably diligent steps to become informed about the matter.

He would also be acting in the best interests of the company if either he had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter, or he declared the interest in respect of Section 75 discussed above.

Furthermore, he would be considered to be exercising care, skill and diligence if he made a decision, or supported a decision of a committee or the board with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company. A director is entitled to rely on the performance of one or more employees of a company whom the director reasonably believes to be reliable and competent in the functions performed, or the information, opinions, recommendations, reports or statements, including financial statements and other financial data prepared or presented by any of the above persons. This reliance is extended to legal counsel, accountants, or other professional persons retained by the company, the board or a committee, as to matters involving skills or expertise that the director reasonably believes are matters within the particular person's professional or expert competence; or as to which a particular person merits confidence; or a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence. The director may also rely on the performance of any person to whom the board may reasonably have delegated formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law.

Liability of directors

In terms of this section of the Companies Act No 71 of 2008 liability extends to an alternate director, prescribed officer or member of a board committee or of the audit committee of the board.
If a director breaches his fiduciary duty (duty to disclose personal interests, abuses power, does not act in good faith and for proper purpose in the best interests of the company) he will be liable for any loss, damage or costs sustained by the company as a consequence of any breach by the director.

If a director fails to exercise the requisite due care, skill and diligence, or breaches any other provision of either the Company's Act or the Memorandum of Incorporation, he will be delictually liable for any loss, damage or cost sustained by the company as a result of the breach.
Broadly speaking, a director will be liable for direct or indirect loss, damage or costs sustained by the company if:

1. He/she acts beyond the scope of his authority.
2. He/she allowed the company to carry on business with the knowledge that it was being conducted recklessly, negligently and fraudulently, or with the knowledge that the company traded under insolvent circumstances (see section 22).
3. Being party to an act or omission of the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder, or had another fraudulent purpose.
4. He/she signed, consented to, or authorised any financial statements, prospectus or written statement that is false, misleading or untrue. Here the director's knowledge and the materiality of the misrepresentation would be factors for consideration in assessing the liability of the director.
5. Failing to vote against, or participating in, the issue of unauthorised shares, the issue of authorised securities, the granting of options, the provision of financial assistance, approval of a distribution, acquisition by the company of its shares, or that of its holding company, or allotment by the company in contravention of the companies act.

Liability extends jointly and severally but a director does have at his disposal a mechanism to apply to court to set aside a decision of the board for which he may be held liable. The court has the discretion to set aside the decision in whole or in part, and to make any further order, for example rectify the decision, reverse a transaction and even indemnify the director for the costs of the proceeding. Recovery of loss, damage or costs, is limited to a prescription period of three years after the act or omission that gave rise to that liability.

> Section 78 limits the extent to which a company may indemnify a director.
>
> The role of a director is very onerous and is to be regarded in a rather serious light. Anyone accepting such an appointment must at all times ensure that they are fully aware of their rights, duties and obligations, and ensure that every question in their mind is answered prior to taking a decision.
>
> (Saica.co.za, 2012)

The board of directors is thus responsible for common law duties (good faith fiduciary duties and acting with the necessary care and skill while performing these duties).

In summation we may say that there are four roles, which a director must fulfil with regards to fiduciary duties:

- Preventing a conflict of interest;
- Not exceeding the limitation of their powers;
- Maintaining discretion; and
- Using their power for the correct purposes.

(Adapted from Law24.com, 2013)

Role of the Board Committees

The board of directors is accountable for the affairs of the company, but they may appoint various subcommittees and managers to assist them in corporate governance.

These subcommittees are formed according to appropriate ordinances; including having a monitoring and reporting system to ensure their actions conform to company policies of ethics and accountability.

There are agreed terms of reference, which stipulate how the board committees should act. Each of the subcommittees has a chair who reports the relevant feedback in meetings of the board of directors. This chair will be a non-executive director who is also required to attend meetings to answer any questions posed to the committee.

According to the Company's act, the following is expected of the board committee:

Board Committees

The directors may appoint any number of board committees it deems fit and delegate any authority to a committee. The Act does not stipulate the types of board committees required. Unless limited by the Memorandum of Incorporation or a resolution establishing a committee, a person who is not a director of the board may be appointed to a committee; but that person is not allowed to vote on a matter and must not fulfil the ineligibility and disqualification criteria established for directors. Although a committee of the board has the full authority of the board in respect of the matter referred to it, it must be understood that a board may delegate authority but never accountability. The drafters have closed the loop of possible uncertainty by further providing that the creation of a committee, delegation of any power to a committee, or action taken by a committee, does not alone satisfy or constitute compliance by a director with the required duty of a director owed to a company.

It is therefore recommended that a board ensures that clearly documented mandates are provided to board committees and, furthermore, ensures that a proper reporting framework is instituted to facilitate reporting by board committees to the board. An overarching board charter clearly stating the principles of, and intention behind, delegation to board committees would also diminish uncertainty and the danger of something falling through the cracks.

(Saica.co.za, 2012)

Role of the Company Auditor

The auditor is responsible for reporting the correct financials to the board with a consideration of the company's corporate governance policies, its risk management strategies, and its systems of internal control (Law24.com, 2013).

The responsibilities of the auditor are outlined in the Company's Act as follows:

Auditors

A public company or state-owned enterprise must, upon incorporation and at each annual general meeting, appoint a registered auditor. A private or non-profit company that is required to have their annual financial statements audited must also appoint a registered auditor meeting the Act's requirements.

The Act precludes any of the following persons from being appointed as an auditor of a company:

- A director or officer of the company
- An employee or consultant of the company who has, or has been engaged for more than one year in the maintenance of any of the company's financial records, or the preparation of any of its financial statements
- A director, officer or employee of a person appointed as company secretary
- A person who regularly performs the functions of an accountant, bookkeeper or secretary of the company
- A person who complied with any of the above categories during the five financial years immediately preceding the date of appointment

A company is required to maintain a record of its auditors, including the name and former name of such person and date of appointment. Where a firm, or juristic person is appointed, the record must include the name, registration number, registered office and the name and date of appointment of the individual determined by that firm to be responsible for performing the audit.
The audit committee (if required) must be satisfied with the auditor's independence.

When an auditor resigns, it is effective from the date that the notice was filed and a new auditor must be appointed within forty business days. The board appoints the auditor, subject to the provision that the audit committee may reject the proposed appointment. Stringent time lines apply in that the board ought to have made a proposal to the audit committee within fifteen business days of the vacancy arising, providing the audit committee with a further five business days to reject the proposed appointment in writing. Where a firm of auditors has changed its auditors resulting in less than one half of its members remaining after the change, that change constitutes a resignation by the firm of auditors giving rise to a vacancy.

Rotation of auditors must occur every five years. It would be prudent for a company that has joint auditors to ensure that all of the joint auditors do not relinquish office in the same year.

The Act enshrines the right of the auditor to access to accounting records and all books and documents of the company at holding company and subsidiary level. The auditor is also entitled to require from the directors and officers of the company, any information and explanations necessary for the performance of the auditor's duties. The auditor's rights also extend to the right to receive notification of, attend and be heard at any general shareholders' meetings. Clearly, it would be most appropriate for the auditor to prepare for the shareholders' meeting and consult with parties such as the company secretary, chairman and investor relations manager, prior to the meeting, in order to appropriately manage the potential risk of shareholders and press receiving the wrong message or misconstruing the facts. Of course, an auditor should not be tempered where a breakdown in corporate governance, for example, is being covered up. The auditor's rights are enforceable in a court that may make an order that is just and reasonable to prevent frustration of the auditor's duties. The court may also make an order of costs personally against any director or officer whom the court has found to have wilfully and knowingly frustrated the performance of the auditor's functions.

The provision of non-audit services by an auditor is limited in that the auditor may not perform services that would create a conflict of interest in terms of the Auditing Profession Act or as may be determined by the company's audit committee.

Audit Committees

At each annual general meeting, a public company, state-owned enterprise or other company that has voluntarily determined to have an audit committee, must elect an audit committee comprising at least three members unless the company is a subsidiary of another company that has an audit committee that will perform the audit committee functions on behalf of that subsidiary.

Each member of the audit committee must be a director of the company. Provision is made for the Minister to prescribe minimum requirements with regard to the financial knowledge and experience required of a member of the audit committee. Clearly, this would create a greater demand for an already scarce resource. The Minister prescribed in Regulation 42 that at least one-third of the members of the audit committee at any time must have academic qualifications, or experience in economics, law, corporate governance, financial, accounting, commerce, industry, public affairs or human resource management. The audit committee member must also be what used to be classified as 'independent'. Without referring to the term 'independent' the Act requires a member of the audit committee to not be:

- Involved in the day-to-day management of the company, or have been so involved at any time during the previous three financial years
- A prescribed officer or full-time executive employee of the company, or have been such at any time during the previous three financial years
- A material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised in that relationship
- Not be related to any person described above

The terms of reference of the audit committee would include nominating the auditor for appointment. In nominating the auditor, the audit committee must consider the independence of the auditor, determine the auditor's fees and terms of engagement and ensure the auditor's appointment is in compliance with prevailing legislation. The rather contentious issue of the provision of non-audit services must be dealt with at audit committee level by the establishment of the company's policy on the provision of non-audit services by the auditor and the pre-approval of any proposed agreement with the auditor for the provision of non-audit service. As opposed to previous practice where the audit committee, along with other board committees, would be reported on in the corporate governance section of a company's annual report, the Act requires the audit committee to prepare a report for inclusion in the financial statements describing how the audit committee carried out its functions, stating its level of satisfaction with the independence of the auditor, and providing comment on the financial statements, accounting practices and internal controls of the company.

The ambit of the audit committee also extends to the receipt and dealing with of any complaints around the accounting practices and internal audit of the company, content or auditing of the company's financial statements, internal financial controls of the company, or any other related matter. It is also a requirement that the audit committee provide submissions to the board on accounting policies, financial control, records and reporting. The board may also delegate further functions to the audit committee, including the development and implementation of a policy and plan for a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes within the company.

The power of the audit committee extends to the ability to reject an appointment of an auditor at an annual general meeting on the basis of lack of independence.

In its assessment of the independence of the registered auditor the audit committee is required to delve into matters such as ascertaining whether any direct or indirect remuneration or benefit was received except in his/her capacity as auditor and in the provision of non-audit services; and whether the auditor's independence may have been prejudiced as a result of a previous appointment as auditor or due to any other consultancy or advisory work undertaken for the company. Lastly, there must be consideration of other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board of Auditors.

Where previously it was practice for a board to obtain external professional advice, this privilege is extended to the audit committee, the cost of which must be paid for by the company, to the extent that it is reasonable.

Having conferred such powers and duties on the audit committee, the drafters of the Act found it necessary to stipulate that the functions and duties of the board of directors are in no way reduced, except with respect to the appointment, fees and terms of engagement of the auditor. One wonders whether this statement is aimed at negating the created perception that the audit committee does seem more powerful than the board!

In increasing the accountability and reporting requirements of companies, the Act has also expanded the role of the auditor and the audit committee, increasing their powers and accountability. The auditor now has a greater voice and must use it when necessary in order to fulfil its functions to the extent envisaged by the Act.

(Saica.co.za, 2012)

Role of the Company Secretary

The company secretary's fundamental role with regards to corporate governance is to direct the board to fulfil its responsibilities and duties properly (Law24.com, 2013).

According to the Companies Act, this includes adhering to the following:

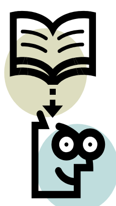
Duties of the Company Secretary in terms of the Companies Act, No 71 of 2008

The Companies Act, No 71 of 2008 details the duties of the Company Secretary as follows:

1. A company secretary is accountable to the company's board
2. A company secretary's duties include but are not restricted to:
    a. Providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers
    b. Making the directors aware of any law relevant to or affecting the company;
    c. Reporting to the company's board any failure on the part of the company or a director to comply with this act
    d. Ensuring that minutes of all shareholders' meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, are properly recorded in accordance with this act
    e. Certifying in the company's annual financial statements whether the company has filed returns and notices in terms of this act, and whether all such returns and notices appear to be true, correct and up to date
    f. Ensuring that a copy of the company's annual financial statements is sent, in accordance with this act, to every person who is entitled to it
    g. Carrying out the functions of a person designated in terms of section 33(3) (i.e. Filing information returns in terms of annual transparency and accountability report)

Task Questions

1. Assess why an understanding of separate legal personality is necessary when dealing with corporate governance.
2. In accordance with the Companies Act, consider who is most accountable with regards to corporate governance:
    a. Directors
    b. Board committees
    c. Auditors
    d. Company secretary



How would you think legislation on the constitution of companies in South Africa compares to other BRICS nations?

Draw conclusions about corporate governance legislation based on the differences/similarities between corporate governance and business ethics in developing nations.

7.3.4 Conclusion

While directors and boards are not necessarily bound to follow strict codes of business ethics, legislation regulates many aspects of ethical company behaviour – and the constitution of a company. Especially as emerging economies, the BRICS countries are bound to follow these on their way to becoming the centre of the new market economy.

Recap Questions

1. Critically compare the terminology used in policy documents of the BRICS relating to corporate governance.
2. Evaluate the necessity of having symmetry in business ethics between the different BRICS countries.
3. Analyse South Africa's corporate governance guidelines according to the King III Report – argue for the importance of such a document.
4. Create your own diagrammatic model representation of King III and indicate how this could be applied to your own business.
5. Using an application of King III to your own business, evaluate whether or not King III is sufficient to creating good corporate governance.
6. Argue whether or not the law should have jurisdiction over the creation of companies.

7.4 RISK MANAGEMENT

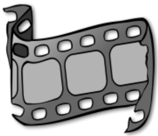
Timeframe:	Minimum 20 hours
Learning outcomes:	• Demonstrate a critical understanding of the importance of risk management as a key role of the board of directors to develop and manage risk in the business environment. • Critically analyse the importance of risk management by studying case studies of poor corporate governance that has resulted in corporate collapse.
Recommended reading:	• Merton, R.C. 2013, 'Innovation: How to Make Smarter Decisions', *Harvard Business Review*, April 2013, http://hbr.org/2013/04/innovation-risk-how-to-make-smarter-decisions/ar/1 (accessed 10 April 2014). • Petrick, J.A. and Scherer, R.F. 'The Enron Scandal and the Neglect of Management Integrity Capacity', *Mid-American Journal of Business*, 18 (1), 37-49, http://www.emeraldinsight.com/journals.htm?issn=1935-5181&volume=18&issue=1&articleid=1917819&show=html (accessed 29 January 2014). • Robins, F. 2010, 'Learning from corporate mistakes', *Corporate Communications: An International Journal*, 15 (2), 169-180, http://www.emeraldinsight.com/journals.htm?issn=1356-3289&volume=15&issue=2&articleid=1858828&show=html (accessed 27 January 2014). • Vinten, G. 2002, 'The corporate governance lessons of Enron', *Corporate Governance*, 2 (4), 4-9, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=4&articleid=873155&show=html (accessed 29 January 2014).
Recommended Multimedia:	• Ask the Ethics Guy, 2011, ‘Risk Management Vs Ethics’, http://www.youtube.com/watch?v=C0NRPC27EGc (accessed 10 April 2014).
Section overview:	It should now be clear that risk management is one of the most important responsibilities held by the board of directors. In this section, the reasons why being aware of risk and managing it are necessary in the context of good corporate governance are looked at in greater detail. In order to emphasise the importance of risk management, three case studies are provided which illustrate the devastating consequences of a lack of risk management which caused the collapse of three big corporations.

7.4.1 Introduction to Risk Management

This control system works by a constant and up-to-date evaluation of the risks the company is engaged in to ensure that they are being operated in a legitimate way. Risk management only works if risk evaluation occurs across the entire organisation (Fisher, 2010:4).

However, as with the ethical considerations, the requirements of risk management need to be fairly evaluated against the legitimate need to take calculated risks in the business environment in order to maintain innovation and retain and increase profits. By integrating risk management into company strategy, this dilemma may be solved (Drew and Kendrick, 2005:20).

Watch the following video to see how ethics and risk management are related:



Ask the Ethics Guy, 2011, 'Risk Management Vs Ethics', http://www.youtube.com/watch?v=C0NRPC27EGc (accessed 05 February 2013).

7.4.2 Defining Risk

Risk can be broadly defined as 'strategic moves that cause returns to vary, that involve venturing into the unknown, and that may result in corporate ruin – moves for which the outcomes and probabilities may be only partially known and where hard-to-define goals may not be met' (Drew and Kendrick, 2005:21).

The extent and full appreciation of risk can only be understood by assessing the industry in which your organisation is operating. Consider this by looking at the example below:

A financial corporation's risk might refer to credit risk, interest rate risk, liquidity risk, market risk and operational risk. But a multinational corporation's risk might refer to the diverse political, economic, and financial risks of the multitude of countries in which it operates.'

(Drew and Kendrick, 2005:21)

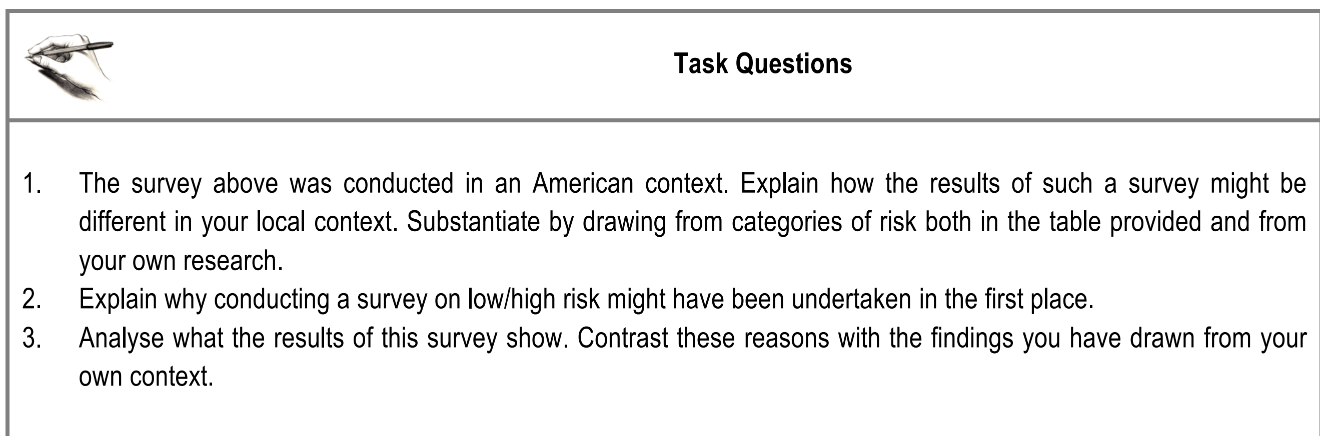
Risk may emerge from the internal or external environments of the corporation and may be either long or short-term. Some forms of risk, for example financial or political risk, can be measured (Drew and Kendrick, 2005:21).

In a survey of the most common types of risk, LRN (2006:2) conducted a survey to document how people perceived the following categories of risk as either low or high threat to the business:

Table 1: Categories of risk

High Risk:	Low Risk:
Reputational Risk (19%)	Terrorism (-8%)
Regulatory Risk (18%)	Financing Risk (-9%)
IT Network Risk (12%)	Political Risk (-11%)
Credit Risk (10%)	Other (-15%)
Market Risk (9%)	Natural Hazard Risk (-18%)
Foreign Exchange Risk (7%)	Crime and Physical Security (-19%)
Country Risk (2%)	

Using the results of the survey as indicated in the table above, complete the task below:



Task Questions

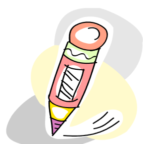
1. The survey above was conducted in an American context. Explain how the results of such a survey might be different in your local context. Substantiate by drawing from categories of risk both in the table provided and from your own research.
2. Explain why conducting a survey on low/high risk might have been undertaken in the first place.
3. Analyse what the results of this survey show. Contrast these reasons with the findings you have drawn from your own context.

7.4.3 Managing Risk

Due to the proliferation of risks as mentioned above, it is necessary for organisations to manage risk. But how is an uncertain factor such as risk managed? Businesses differ over the type of risk management strategies to adopt.

Enterprise risk management (ERM) model

One strategy your business may choose to adopt is based on the Enterprise risk management model. Enterprise risk management (ERM) can be defined as follows:



"Enterprise risk management (ERM) is the process of aligning competitive strategy with the mechanisms that identify, aggregate, mitigate, avoid and transfer risk. The goal is to reduce losses while seizing opportunities."

(LRN, 2006:2)

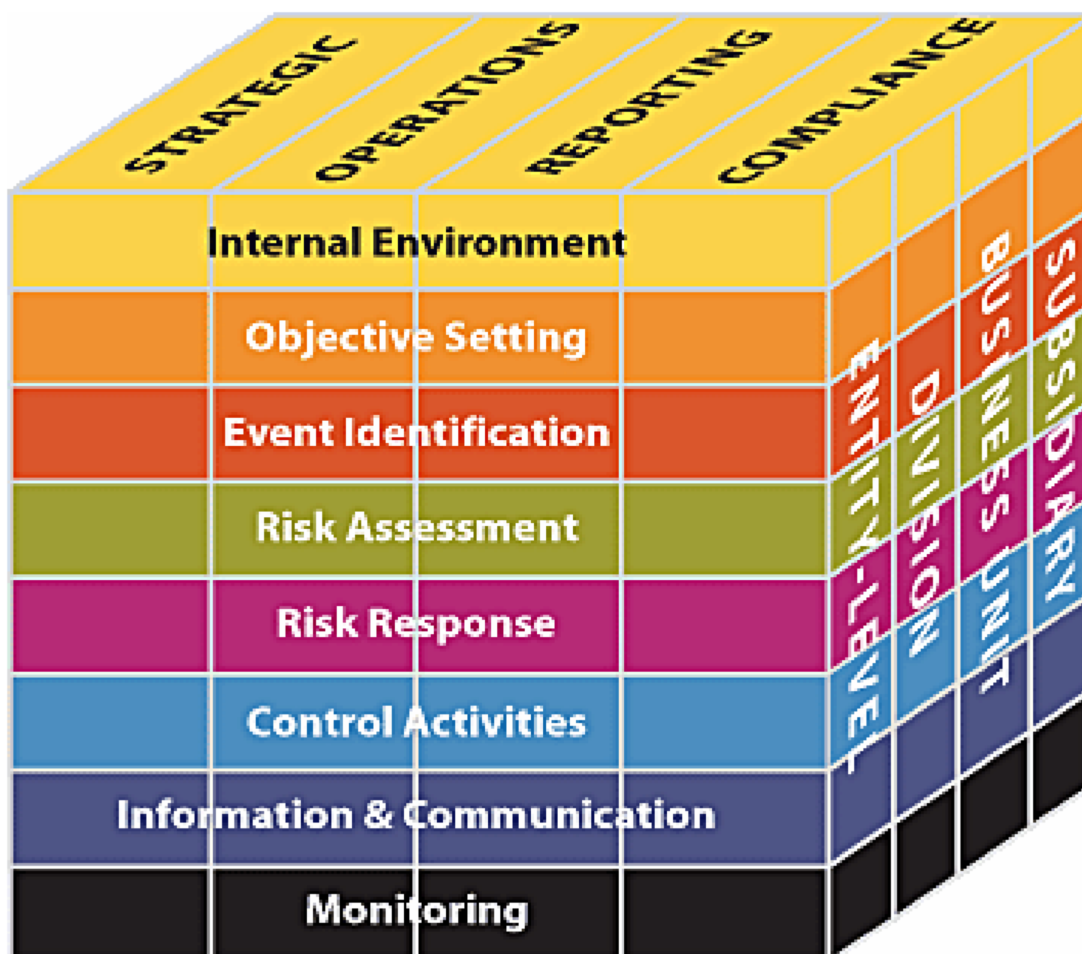
As the definition explains, Enterprise Risk Management is the alignment of the organisation's strategy with the structures in place to minimise risk. This implies that from the conception of the strategy, risk should be considered a factor that must be part of the organisation's overall direction, not merely an afterthought.

Further, enterprise risk management recognises that risks do not exist in isolation. According to Lam (2003:41), risks by their very nature are ‘dynamic, fluid, and highly interdependent.’ This means that they cannot be assessed and dealt with independently, but rather that organisations need to create integrated approaches to managing risks. Enterprise risk management ensures the direct management of risks, the coordination of risk management activities, and monitoring the risk management of senior management (Lam, 2003:41).

This means that directors and executives use ERM to group these diverse management activities in order to identify potential risks that may be presented by individual employees, different departments or divisions in the business, leaders within the business, and factors in the external environment (LRN, 2006:3).

An example of how to do this is illustrated below:

Figure 5: An ERM Framework



(LRN, 2006:2)

The example of ERM above comes from the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in the United States. It shows the various categories of risk (on the top of the block), together with the organisational departments (at the side), and the different components of risk management (on the front). As the model shows, in this approach the components of ERM (internal environment, event identification, risk assessment, risk response, control activities, information & communication, and monitoring) are used to achieve the goals of risk management.

Task Questions
1. Evaluate the applicability of this model to your own organisation.

Role of the Board of Directors in Managing Risk

As we have already examined, the board of directors has a number of responsibilities around corporate governance. The role of the board in managing risk is particularly important considering the perception held by the public and in some governments that excessive risk-taking is responsible for the global economic crisis that began in 2008 and resulted in the recession. As Lipton *et al* have noted, 'The risk oversight function of the board of directors has never been more critical and challenging than it is today. (Lipton *et al*, 2008:1).

In such an environment, where there is currently a call for harsher regulatory and legislative measures, boards must keep ahead of corporate governance trends by becoming more self-regulatory. An example of this is the increasing pressure to ensure that the board of directors remains separate from the management of the corporation so that it can, if necessary, challenge the CEO (Cangemi, 2012:75).

Other examples of demands being made are:

- To upgrade the quality of oversight of risk management strategies;
- To limit the number of boards directors may serve on; and
- To increase the diversity of the board of directors not only in terms of gender, but also in terms of increasing the diversity of skills.

(Cangemi, 2012:75)

The risk management system should be instituted in such a way that the board remains constantly aware of the greatest risks that the company is taking. In this way, the board can have all the available knowledge concerning the risks and can judge them according to legal and ethical applications.

While there is no risk management strategy that can be applied to all organisations, the board should decide on the best strategy to suit the type of firm and to comply with the relevant corporate governance scheme.

(Adapted from Lipton, 2010)

No matter the risk scheme, well-governed corporations hire senior executives as chief risk officers (Drew and Kendrick, 19). These risk officers should:

- Be independent from the CEO and other managers so that they can dispute managerial decisions if necessary;
- Be able to ask appropriate questions even if management is uncomfortable with answering them;
- Have the ability to follow-up on ethical actions;
- Have strong analytical skills in order to assess what processes need to be improved;
- Form good relationships with management or at least be able to work with management;
- See the organisation from a broader perspective in order to take account of all the current strategies, the organisation's values and objectives, and measure performance levels;
- Comprehend the corporation in terms of global concerns;
- Should understand the auditing process and financial reporting;
- Be risk and control experts; and
- Understand Enterprise (integrated) risk management.

(Adapted from Cangemi, 2012:76)

Five organisational pillars of risk management

According to Drew and Kendrick (2005:28), there is five organisational pillars that contribute to successful risk management: culture, leadership, alignment, structure and systems.

- **Culture**
  Creating a culture of risk management in the organisation ensures that the appropriate values and norms are embraced and internalised by all stakeholders.

- **Leadership**
  Leaders create the culture of risk management and are responsible for the appropriate implementation of its controls.

- **Alignment**
  This means that leaders reinforce the culture of risk management, ensuring that risk management is part of the appropriate structures and is a fundamental part of strategy.

- **Structure**
  Creating a structure, which includes people who are tasked with the responsibilities of ensuring risk management, clear lines of reporting, and committees who monitor risk.

- **System**
  This refers to any systems that are in place to ensure risk management such as IT, auditing or other accounting controls, and knowledge management.

(Adapted from Drew and Kendrick, 2005:28)

This framework can be applied by taking into account:

- The type of work and processes that exist in the organisation;
- The type of risks the organisation faces; and
- The causes of the risks that the organisation faces.

The type of work and processes in the organisation

The risk management controls put in place will differ based upon the nature of the organisation. These controls might also differ based on the different departments in the organisation.

Type of risks faced by organisation

The types of risks that affect the organisation are evaluated by the possible consequences of the occurrence of this risk. As you can see from the figure below, the approach to risk management is determined by comparing the probability of the risk with the consequences of this risk.

Figure 6: Determining risk

	Consequences: High	Consequences: Low
High	•Address the risk now •Deflect and exploit if possible	•Assess the risk •Develop appropriate response in readiness
Low	•Build awareness to avoid surprises •Develop a strong contingency plan •Turn risks into opportunities	•Monitor and defend position •Grow value

(Drew and Kendrick, 2005:31)

There is an endless list of risk factors, but summarising these we may say that the types of risk are:

- Financial risks (for example financial investments which result in heavy losses);
- Fraud (for example may result in financial damage to the organisation or more serious legal consequences for the company);
- Bribery or foreign corruption (for example bribing a public official can have serious negative consequences for the organisation);
- Disasters (for example natural occurrences that damage the buildings or investments of a company);
- Products liability (for example if an organisation is sued due to a faulty product and has to pay damages);
- Health and safety (for example the organisation's regulations must conform to the health and safety standards required by the industry otherwise it can face serious consequences if an employee is injured or killed);
- Environmental (for example if the organisation causes harm to the environment and has to remedy what it has done);
- Insurance (for example, all company assets should be insured against damage or theft)
- Information technology (for example, if the computer systems of a company crash all the valuable information the company needs is lost);
- Intellectual property (for example, it is the company's responsibility to ensure its trademarks, logos, and innovative ideas otherwise these can be seized by others);
- Employment practices (for example, a company must have a clear set of procedures for employee behaviour to make its stance on sexual harassment, wrongful termination, or defamation clear so that employees rights are protected but ensure that they can't take advantage of the company either); and
- Social responsibility and human rights (for example, a company must not commit human rights violations because these could have serious consequences for the continuing operation of the company).

(Adapted from Lipton, 2008:8-13)

Causes of risk

Often the causes of risk are hard to identify because they are caused by a complex set of factors. The more complex the causes of risk; the more in-depth risk management strategies need to be (Adapted from Drew and Kendrick, 2005:29-31).

Risk oversight function of the board of directors

Part of the fiduciary duties of the board of directors is being critically involved in the process of overseeing risk management. Apart from the legal obligations we previously examined, boards may decide on their risk oversight role by looking at industry regulators, such as the banking industry or special committees monitoring risk management (Lipton *et al*, 2008:7).

Lipton *et al* (2008) offer several recommendations for improving risk oversight:

- Committee or subcommittee performing risk oversight function;
- Audit committee;
- Training the board to be good risk managers;
- Compose the board of people trained to be aware of and solve risk;
- Open lines of communication;
- Comply with legal regulations; and
- Anticipate future risks.

(Lipton *et al*, 2008:12-17)

7.4.4 Case Studies

Now it is time for you to apply what you have learned about risk management by studying case studies of companies whose poor corporate governance resulted in financial ruin or total collapse.

Case Study 1: Enron

The Fall of Enron

Throughout the late 1990s, Enron was almost universally considered one of the country's most innovative companies – a new-economy maverick that forsook musty, old industries with their cumbersome hard assets in favour of the freewheeling world of e-commerce. The company continued to build power plants and operate gas lines, but it became better known for its unique trading businesses. Besides buying and selling gas and electricity futures, it created whole new markets for such oddball "commodities" as broadcast time for advertisers, weather futures, and Internet bandwidth.

The Enron story was perfect for the dotcom-driven stock market boom of the '90s. With its roots in the utility business, the company enjoyed a solid reputation for old-economy stability. But unlike other energy companies that didn't "get it," Enron thrust itself headlong onto the Internet. The business press ate it up; so did Wall Street, sending the stock into the stratosphere. At its peak, Enron was worth about $70 billion, its shares trading for about $90 each.

All that came crashing down in October 2001, when the company admitted that it had misstated its income and that its equity value was a couple of billion dollars less than its balance sheet said.

The company, it was revealed, had made about a dozen "partnerships" with companies it had created, and it used those partnerships to hide huge debts and heavy losses on its trading businesses. At the same time, Arthur Andersen, the company that audited Enron's books, at best neglected to recognize the company's problems. At worst, investigators now say, the auditor was complicit in perpetrating one of the biggest frauds in corporate history.

On Dec. 2, 2001, Enron declared bankruptcy. Thousands of people were thrown out of work, and thousands of investors – including most of the company's employees – lost billions of dollars as Enron's shares shrank to penny-stock levels.

Throughout January, revelations poured forth from Enron: tales of shredded documents, stories of Enron execs seeking help from top administration officials, allegations that company officials wilfully ignored internal warnings about the accounting irregularities even as they pocketed millions of dollars in stock-market gains. It quickly became clear that the sudden collapse of the country's seventh-largest company was going to have implications not only for business, but for politics and policy as well: Enron and its officers were among the biggest donors to U.S. political campaigns over the past decade.

Critics say that deregulation of the energy business created the environment for Enron to fall. Chairman and CEO Kenneth Lay was apparently invited to take part in Vice President Dick Cheney's task force on energy policy, which met behind closed doors. To top it off, Enron executives, particularly Lay, are chummy with many in the administration, including (former) President Bush himself, who refers to his friend Lay as "Kenny boy."

(NPR.org, 2013, 'The fall of Enron: collapse felt from workers' homes to halls of government', http://www.npr.org/news/specials/enron/ (accessed 10 April 2014).

To read more about the Enron scandal and its aftermath read the following:

- Petrick, J.A. and Scherer, R.F. 'The Enron Scandal and the Neglect of Management Integrity Capacity', *Mid-American Journal of Business*, 18 (1), 37-49, http://www.emeraldinsight.com/journals.htm?issn=1935-5181&volume=18&issue=1&articleid=1917819&show=html (accessed 10 April 2014).
- Vinten, G. 2002, 'The corporate governance lessons of Enron', *Corporate Governance*, 2 (4), 4-9, http://www.emeraldinsight.com/journals.htm?issn=1472-0701&volume=2&issue=4&articleid=873155&show=html (accessed 10 April 2014).

Case Study 2: WorldCom

Worldcom Scandal: A Look Back at One of the Biggest Corporate Scandals in US History

In 1998, the telecommunications industry began to slow down and WorldCom's stock was declining. CEO Bernard Ebbers came under increasing pressure from banks to cover margin calls on his WorldCom stock that was used to finance his other businesses endeavors (timber, yachting, etc.). The company's profitability took another hit when it was forced to abandon its proposed merger with Sprint in late 2000. During 2001, Ebbers persuaded WorldCom's board of directors to provide him corporate loans and guarantees totalling more than $400 million. Ebbers wanted to cover the margin calls, but this strategy ultimately failed and Ebbers was ousted as CEO in April 2002.

Beginning in 1999 and continuing through May 2002, WorldCom (under the direction of Scott Sullivan (CFO), David Myers (Controller) and Buford Yates (Director of General Accounting)) used shady accounting methods to mask its declining financial condition by falsely professing financial growth and profitability to increase the price of WorldCom's stock.

The fraud was accomplished in two main ways. First, WorldCom's accounting department underreported 'line costs' (interconnection expenses with other telecommunication companies) by capitalizing these costs on the balance sheet rather than properly expensing them. Second, the company inflated revenues with bogus accounting entries from 'corporate unallocated revenue accounts'.

The first discovery of possible illegal activity was by WorldCom's own internal audit department who uncovered approximately $3.8 billion of the fraud in June 2002. The company's audit committee and board of directors were notified of the fraud and acted swiftly: Sullivan was fired, Myers resigned, and the Securities and Exchange Commission (SEC) launched an investigation. By the end of 2003, it was estimated that the company's total assets had been inflated by around $11 billion (WorldCom, 2005).

On July 21, 2002, WorldCom filed for Chapter 11 bankruptcy protection, the largest such filing in United States history. The company emerged from Chapter 11 bankruptcy in 2004 with about $5.7 billion in debt. At last count, WorldCom has yet to pay its creditors, many of whom have waited years for the money owed.

On March 15, 2005 Bernard Ebbers was found guilty of all charges and convicted on fraud, conspiracy and filing false documents with regulators. He was sentenced to 25 years in prison.

Other former WorldCom officials charged with criminal penalties in relation to the company's financial misstatements include former CFO Scott Sullivan (entered a guilty plea on March 2, 2004 to one count each of securities fraud, conspiracy to commit securities fraud, and filing false statements), former controller David Myers (pleaded guilty to securities fraud, conspiracy to commit securities fraud, and filing false statements on September 27, 2002), former accounting director Buford Yates (pleaded guilty to conspiracy and fraud charges on October 7, 2002), and former accounting managers Betty Vinson and Troy Normand (both pleading guilty to conspiracy and securities fraud on October 10, 2002) (MCI, 2006). Ebbers reported to prison on September 26, 2006 to begin serving his sentence.

(Anon, 2007)

Case Study 3: HIH

Lessons from HIH

It lasted over 16 months, covered 3 volumes and cost over $40m. The HIH royal commission into the $5.3 billion collapse of HIH is a very costly case study into how not to run a company, a poor corporate governance culture and risk management gone wrong. Ultimately, the commission concluded that the real problem was mismanagement and lack of oversight. So what can corporate leaders learn from Australia's largest ever corporate collapse?

Using qualified and experienced directors doesn't guarantee success

Between 1997 and 2001, the board included insurance experts, qualified accountants and a QC. With all the expertise, the board was still subservient to the CEO, did not ask enough questions, made poor decisions and were ineffective in managing strategy.

Directors must probe senior management and ask questions

Management controlled the agenda for board meetings, vetted the information and concealed information from board members and auditors'.HIH directors didn't question the key assumptions behind actuarial and auditors' reports. Board was strongly influenced by senior management, from which senior management benefited significantly, to that of a company run primarily in the interests of shareholders. Directors simply accepted senior management recommendation to enter US market without adequate analysis of management's assertions. Est. loss $620M.

Directors cannot abdicate responsibility

5 of the 12 directors were not even present when the board voted to pay $300 million for FAI. The HIH chairman exercised an "abdication of responsibility" in relation to ensuring all directors' conflicts of interests were disclosed.
In the last 3 months of HIH's life, the HIH directors made a decision…to grant themselves fee increases – retrospectively.

Long term strategies need to be developed and questioned

There was little analysis of the future strategy. Perhaps the only time that it was discussed was in the context of the annual budget meeting.

With the pressure on companies to meet analysts' short-term expectations, too often the strategy was to achieve the required profits for the next half-year.

No broad strategy was ever enunciated, directors had nothing against which to measure its performance. No evidence that the board contributed to a business plan when HIH's UK branch was established. Responsibility of board members to understand and then provide diligent oversight of the strategies.

Do not do business with a company related to directors/management

There was a "flawed understanding of the concept of conflict of interest". Two non-executive directors were paid significant consultancy arrangements that were not disclosed.
Williams approved a $2million investment in a business-coaching company controlled by Adler.
HIH lost $38 million on its investment in Home Security plus threw away a further $47 million.

When entering new markets and/or new products, do your homework first

The company expanded into Britain and Hong Kong, wrote US workers' compensation, wrote accident cover to Taiwanese army, wrote motor vehicle cover to Israeli army without terrorism exclusion and expanded into marine reinsurance and film financing. Est. loss $1,700M.

Be very diligent during mergers and acquisitions

With only minimal information, directors approved a Joint Venture deal where HIH's main source of premium income (about $1 billion a year) would be diverted into a trust fund. Within 10 weeks of the start of the joint venture, HIH was placed in provisional liquidation.

"My estimate of the directly quantifiable loss suffered by HIH due to the acquisition of FAI is... $591 million," Justice Owen

Liabilities need to be understood, analysed, properly valued and disclosed

There was a consistent failure of HIH, and FAI before it, to set aside enough money to pay their claims. Under-reserving had arisen because HIH was mismanaged. According to AM Best, 51% of insurance company failures are due to reserve deficiency. Deliberate manipulation of claims estimates by FAI management, contributed to under-reserving. Excessive under-reserving of FAI's long-tail business. Est. loss $590M.

Accountability and propriety is essential at all levels of the organisation

"There was a lack of accountability among senior management...a singular failure to assess performance in the context of deteriorating financial results," Justice Owen.
Mismanaged by the "lack of attention to detail, a lack of accountability for performance".

Unpleasant information was hidden, filtered or sanitised. And there was a lack of skeptical questioning and analysis when and where it mattered. Justice Owen recommended a toughening of the Corporations Law to ensure that employees and advisers can be held accountable for their actions.

Risk Management should go beyond statements, guidelines and policies

"HIH had a corporate governance model. The directors said so in the annual reports," There were guidelines for corporate governance, underwriting practices and investment guidelines. They just weren't adhered to very often. "Risks were not properly identified and managed" Justice Owen. HIH was mismanaged and out of control rather than brought down by fraud and embezzlement. Mismanaged by the "lack of integrity in the company's internal processes and systems".

External regulators need to be more proactive

61 recommendations to tighten the way companies are run, listed and audited. Structural changes to regulatory bodies (ASIC, APRA) and ASX listing rules have been recommended.
The "new APRA" will have an aggressive enforcement culture to make sure this does not happen again. ASIC given a further $17.5 million in May 2003 federal budget to deal with the matters referred by the HIH royal commission.

Be aware of large and/or unusual transactions

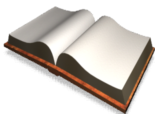
"As the company approached collapse, many strange transactions and events occurred" Justice Owen. HIH entered into reinsurance contracts that delayed the date of payment and shifted the risk back to HIH. "Side letters" relieved a reinsurer of all risk, which turned it into a disguised loan. This allowed FAI to claim about $27million extra profit shortly before HIH's bid for FAI.

Culture affects behaviour and behaviour will ultimately affect performance

There was a culture of apparent indifference or deliberate disregard on the part of those responsible for the wellbeing of the company. Management failures were the direct consequence of a sick corporate culture. In such an environment, systemic problems became routine.

(Australian Financial Review, 2013)

In addition to the case studies provided above, read the case study by Fred Robins (2010) by accessing the link below:



Robins, F. 2010, 'Learning from corporate mistakes', *Corporate Communications: An International Journal*, 15 (2), 169-180, http://www.emeraldinsight.com/journals.htm?issn=1356-3289&volume=15&issue=2&articleid=1858828&show=html (accessed 10 April 2014).

Task Questions

Based on the case studies provided above and with your reading of the case studies in Robins' article, answer the following questions:

1. Critically evaluate and compare the failures in risk management strategies of each collapsed corporation.
2. Using these failures, create a risk management model that could be applied in your business to prevent corporate collapse. The model should take into account the holistic Regenesys Management Model provided at the beginning of this Study Guide.
3. Apply your model to your organisation to assess the current risk management strategy of your organisation.
4. Using this assessment (3), evaluate the importance of risk management for your organisation.
5. Argue how you would apply your risk management model without compromising your company's drive towards innovation.
6. The case study by Robins is more concerned with corporate social responsibility than the case studies provided in this Study Guide. Analyse the role of risk management in corporate social responsibility. Using this analysis, evaluate risk management as a strategy of ethical business.

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9. Glossary of Terms

Term	Explanation
Accountability	The duty to disclose how the company or an individual has carried out official duties and obligations.
Affirmative action	Policies or programmes that attempt to redress past discriminatory labour practices by providing employment opportunities to groups that have suffered from discrimination in the past.
Audit	An official inspection of the company's account either on an internal or external basis. An internal audit involves an employee of the company testing the company's internal control systems and assessing its operating systems.
Board	The group of elected individuals responsible for corporate governance of a company. The board commonly consists of the chair, executive directors and non-executive directors.
BRICS	Abbreviation for Brazil, Russia, India, China and South Africa – a collection of developing economies.
Compliance	Meeting certain legal and regulatory requirements.
Corporate Social Responsibility (CSR)	The organisation's management of the impact of its activities and outputs on economic, social and environmental factors.
Governance	The system by which companies are directed and controlled.
Risk	The likeliness of a situation that would have a negative impact on the business occurring. There are five types of risk: financial, fundamental, operational, particular and pure risk. • Financial risk refers to the risk that the company may lose cash flow. • Fundamental risk is the risk that unforeseen events may impact negatively on the business (for example, natural disasters). • Operational risk is risk that would result from the failure of an internal operation (systems, procedures and processes, or people). • Particular risk is risk that is controlled risk (for example, working with machinery) • Pure risk is where only loss or damage may follow the event (for example, a fire breaking out).
Risk management	The assessment, analysis and control (to whatever degree possible) of risk. Involves identifying, diagnosing and assessing the risk.
Spiritual leadership	Leadership that recognises one's own spirituality in order to understand how the values, beliefs, attitudes and behaviours that motivate employees contribute to employee well-being, sustainability and corporate social responsibility.
Stakeholders	Person or group with an invested interest in an organisation (employees, customers, suppliers, creditors, and even the local community).
Transparency	Open access to information, particularly financial information. Also referred to as "full disclosure."
Whistleblowing	When a person who works for an organisation or is involved with the organisation (i.e. as an auditor) reports financial or other corporate misconduct to an external source.
Triple Bottom Line	A measure of sustainability that includes social, environmental and financial factors. Based on these factors, a calculation of the organisation's success may be carried-out. However, deciding what to use to measure social and environmental success may be somewhat more difficult than measuring financial success.

(Adapted from ICSA.org.uk, 2014, the freedictionary.com, 2014, Investopedia.com, 2014