

INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 5 | Issue 1

2022

© 2022 International Journal of Law Management & Humanities

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com/>)

This Article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in the International Journal of Law Management & Humanities after due review.

In case of any suggestion or complaint, please contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication at the **International Journal of Law Management & Humanities**, kindly email your Manuscript at submission@ijlmh.com.

Incorporating Ethics as a part of Corporate Governance: Importance and Need for a Framework

RAJAT SRIVASTAVA¹ AND SRI SAI KAMALINI M.S²

ABSTRACT

Corporate Governance plays a crucial role in regulating the corporation and the employees' conduct and helps prevent fraud. Though ethics is considered an essential aspect of Corporate Governance, the inclusion is not made mandatory for all in any specific framework, and there is no way to assess the incorporation of ethics in the corporate governance codes and code of conduct developed by the Company. Though various companies have their code of conduct to adhere to ethical practices, there is no uniform policy, and the incorporation of ethics is not seen in many companies. Thus the main aim of this paper is to reiterate the importance of ethics and how it is a critical factor in regulating the company's success. The paper also aims to bring out the need for conduct or framework, including ethics in Corporate Governance.

Keywords: *Corporate Governance, Business ethics, Corporate Social Responsibility, Framework.*

I. INTRODUCTION

The term "proper governance" consists of transparency, proper appointment, abiding by the rules and codes of the country where the Company or organisation is present, maintaining confidentiality, and ensuring that the Corporate Social Responsibility Guidelines are followed. Corporate Social Responsibility in India is constantly interchanged with each other in various situations, But the reality is often different, as there are certain companies though they follow the Corporate Social Responsibility guidelines provided by the Indian Government, they might not follow ethical practices. The SEBI (Prohibition of Insider Trading) Regulations, 2015 and Section 17(5)(a) and Section 17(5)(b) the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR) mentions the need for Code of Conduct for directors and the upper management which includes the ethical aspects. But it must be noted there is no separate framework that concentrates on business ethics. The Company must also

¹ Author is a LLM student at O.P Jindal Global University, India.

² Author is a LLM student at O.P Jindal Global University, India.

act with ethical standards that develop the Company's reputation and give confidence to the investors and the shareholders.

Ethics also impacts the financial performance, the Companies which shows more commitment to ethical practices always have a significant advantage over their competitors. The theories of ethics and corporate governance aid us to understand how this subject works and the relation between various aspects of the subjects.

II. DECODING ETHICS AND ETHICS OF CORPORATE GOVERNANCE

The word "ethics" is derived from the Greek word *ethos* (character) and the Latin word *mores* (customs). Together, they combine to define how individuals interact with one another. In philosophy, ethics defines what is suitable for the individual and society and establishes the nature of duties that people owe themselves and one another.³

In simple words, ethics refers to the conduct that should be the driving force behind an individual's act or conduct rather than the action that he/she would take driven by his/her selfish motive. Since ethics and morals are concerned with the performance of any action in a particular way, they are used interchangeably. Be that as it may, there are a few contrasts between the two terms. Ethics is about appropriate or inappropriate activities, actions that are correct or wrong, and reasonable or unreasonable choices, whereas morality changes from one person to another because people's qualities and social characteristics might contrast.⁴ Further, as indicated by one individual, moral might be immoral. Moral guidelines, along these lines, cannot be viewed as ethical standards in specific settings. What is moral or immoral relies more upon the strict fundamentals of the religion of different groups of people around the globe. Nonetheless, ethical standards might be familiar to all religions.

The ethics of corporate governance alludes to the moral qualities that support and guide a corporate governance system on the administrative or the endeavour level. Assuming a worthy framework is perceived as a bunch of feelings regarding what is significant - and in this manner what ought to be given need - then, at that point, the ethics of governance is an outflow of explicitly the ethical needs that illuminate and guide a corporate governance framework. These qualities that illuminate and guide a corporate governance framework may be enunciated transparently and unequivocally, or they may be imperceptible and not referenced by any stretch of the imagination. Whether or not the hidden and directing qualities are referenced

³ *Ethics*, LII /Legal Information Institute, (Jan 29, 2022), <https://www.law.cornell.edu/wex/ethics>.

⁴ *You say morals, I say ethics- what's the difference*, The Conversation,(Jan 29, 2022), <https://theconversation.com/you-say-morals-i-say-ethics-whats-the-difference-30913>.

expressly does not modify in any capacity the way that such a worthy framework exists in situations where the fundamental and directing upsides of a corporate governance system are not unequivocally expressed, it tends to be uncovered by testing into the interests and goals that corporate administration should serve. The guidelines or necessities related to corporate governance give an impression of which roles, obligations, goals, and commitments organizations have in each society. By asking a question like, "In whose interests should organisations be run?" or "What are the targets of a corporate administration framework?" the supporting and supplementary upsides of a corporate governance system can be uncovered. Distinguishing the ethics of a particular corporate governance framework consequently comes down to certain ethical obligations like investing in transparency, empowering stakeholders to view the direction of corporations and have a chance at guiding the company's moral compass, Being available and having open channels of communication where stakeholders can interact with the corporation, operating within the letter of the law, Understand their social and environmental impact and make investments to reduce the negative effects of their business operations etc., and commitments of enterprises in the public eye, just as the and commitments of enterprises in the public eye, just as the ethical qualities related to these obligations and commitments. Indeed, even in situations where the value system is expressly expressed, it is a good idea to test whether the purported esteem framework to be certain tracks down articulation in the guidelines or necessities of the corporate administration framework. It is not exceptional to observe logical inconsistencies between the purported esteem framework and the worth framework that is sneaking verifiably in the guidelines or suggestions of a corporate governance regime.

When the value system of a corporate governance framework has been expressed, the ethical ramifications of the recognised corporate governance system can be assessed. The targets and interests focused on by the corporate administration esteem framework can be surveyed for how reasonable, dependable, or socially considerate they are. Likewise, it can be assessed how comprehensive or selective the corporate governance framework serves the interests. Does the corporate framework, for instance, serve the interests of all partners of enterprises or just the interests of explicit corporate partners? Are generally shareholders being dealt with similarly, or are the interests of certain shareholders only instrumental to the interests of different shareholders? What objectives are corporations expected to seek after, and how are the different goals? What objectives prevail over the others on a compromise, or do companies rely upon all objectives to seek an equal balance? Reactions to these inquiries give a corporate governance framework's ethics of governance profile.

III. INCORPORATING ETHICS IN CORPORATE GOVERNANCE

The issue of ethics in corporate governance is not new but is relatively new. It emerged during the 1970s and was gradually acknowledged as an academic discipline and practice through decades that are followed.⁵ Corporate ethics is dynamic. While some may accept that it is instinctively clear that an organisation ought to be ethically compelled to act inside society's standards, the unadulterated promoters of capitalism do not concur. In other words, the core values that emerge through study might shift after some time. While specific standards stay concrete, accepted practices might fluctuate after some time, constraining once-satisfactory practices into outdated quality. The natural development and the acknowledgement that we are annihilating our planet might have changed the public's view of non-renewable energy source utilisation. When the vehicle business emerged, consuming more gas to gather more power was embraced proficiency presently and limiting discharges is the norm.

Today the world is more globalised, and the economies are more liberalised than ever. Corporations today have a cut-throat competition, and for survival, they are ready to compromise on any component. The wave of corporate governance change all over the globe throughout the most recent twenty years is frequently viewed as an endeavour to re-establish trust in business after major corporate scandals had disintegrated public confidence in corporations. The Cadbury Report⁶, for example, followed in the wake of the Maxwell scandal in the UK⁷, and Sarbanes-Oxley in the USA⁸ followed the collapse of Enron⁹. What differentiated these imploded from other corporate falls and transformed them into corporate scandals were the widespread and fundamental unethical practices in these organisations that ultimately brought about their downfall. The corporate governance change that followed these scandals is seen as an endeavour to guarantee that enterprises lead their undertakings with trustworthiness and reasonable, straightforward, and dependable. Accordingly, there is a connection between unethical corporate conduct and corporate scandal, yet a connection between corporate governance change and the desire for improving organisations to be more ethical and dependable. Regardless of this good connection between corporate governance and ethics, the ethics of corporate governance stays an ignored region in corporate administration

⁵ Douglas R McKay, Romy Nitsch & Daniel A Peters, *Corporate governance and business ethics*, 23 *Plast Surg (Oakv)* 271–272 (2015), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4664146/> (last visited Jan 29, 2022).

⁶ Cambridge Judge Business School: The Cadbury Archive: The Cadbury Report, , <https://cadbury.cjbs.archios.info/report> (last visited Jan 29, 2022).

⁷ THE MAXWELL SCANDAL - The Washington Post, <https://www.washingtonpost.com/archive/opinions/1991/12/09/the-maxwell-scandal/fa08ac8d-5be3-44f4-b373-bf3d8aa2de93/> (last visited Jan 29, 2022).

⁸ Sarbanes -Oxley Act of 2002.

⁹ Enron Scandal: The Fall of a Wall Street Darling , Investopedia , <https://www.investopedia.com/updates/enron-scandal-summary/> (last visited Jan 29, 2022).

research by and large, yet in addition explicitly in worldwide near corporate governance research. Although various corporate governance codes of different countries around the globe have some ethical obligations to be followed by different actors of a corporation to date, there is no separate code of ethics for corporations with legal sanctions. Part of the clarification for this disregard of ethics in corporate administration examination is the suspicion that corporate governance involves corporate law rather than a question of corporate ethics. Particularly in the US setting that rules the worldwide corporate governance discourse, corporate governance is viewed as an issue of controlling organisations to guarantee that supervisors and chiefs satisfy their guardian obligations towards owners of organisations.

Another scandal that shocked the regime of corporate governance and brought to light the high unethical standards being followed in one of the major corporations in India was the Satyam scandal¹⁰. Satyam scam is unparalleled in India's corporate history and, as some keen corporate observers point out, the World itself. The scandal was so big that it forced the government to rethink the corporate governance practice being followed in India. The Ministry of Corporate affairs in 2009 issued a set of voluntary guidelines for corporate governance on specific issues¹¹. The companies act was also amended, and a new overhauled companies act 2013 came into force, which included specific new provisions related to the responsibility and accountability of various key personnel's that contribute to an organisation's governance.¹² This fraud was purely motivated by personnel greed, and the CEO of Satyam Computers, Ramalinga Raju, took all the responsibility for the fraud, stating that he was behind this fraud and no one else was involved in this unethical practice. Another recent major scandal that fueled the ire of those who question the altruism and decency of the intent of big businesses is the Volkswagen emission scandal.¹³ It became exposed that Volkswagen intentionally beguiled the United States Environmental Protection Agency (EPA) regarding nitrous oxide (NOx) engine emission for their TDI motors. The automobile giant customised the vehicles to well act distinctively during EPA testing. The motors surpassed emission test levels by about 40 percent during each day. The quantity of impacted vehicles is not tiny - roughly 11 million vehicles worldwide.

All these abovementioned scandals and numerous other's that go unreported are prime examples of how unethical behaviour in an organisation can lead to its downfall. Also, these

¹⁰ Satyam Scam, Satyam Scandal - Definition, Understanding, and Why Satyam Scam, Satyam Scandal is Important? <https://cleartax.in/g/terms/satyam-scam-satyam-scandal> (last visited Jan 29, 2022).

¹¹ Corporate Governance Voluntary Guidelines, 2009

¹² Companies Act, 2013

¹³ Volkswagen Company's Emissions Scandal: Ethical Dilemma |, StudyCorgi.com, <https://studycorgi.com/volkswagen-companys-emissions-scandal-ethical-dilemma/> (last visited Jan 29, 2022).

scandals emphasise the need to implement high ethical practices in the corporate governance framework of an organisation. Although the various corporate governance laws that are being followed around the globe are said to be in concord with ethical practices, the law and ethics are not the same. The law can guide ethical behaviour through acts and compliances by laying out a framework, but following the law and behaving ethically is not one thing. For example, the Sarbanes-Oxley lays down that destroying evidence or fraudulent behaviour is illegal, and it necessarily does not state the series of objectionable decisions that lead to the fraud. To answer this lacuna, corporations must turn to the field of corporate ethics. Like in the case of Volkswagen, the execution of the misleading PC program at the EPA emission test research centre is the place where the law was broken, the demonstration of which conveys reformatory fines and punishments because of the retaliations of wrongdoing and discipline. The work before that breach and the culture of misdirection that carried it to realisation comprises many ethical violations according to social norms.

IV. THEORIES OF ETHICS AND CORPORATE GOVERNANCE

(A) Business ethics theory

Business ethics act as a guide that helps conduct the business and make the business successful. The business needs to stay ethical by maintaining the basic standards and needs of the stakeholders, but at the same time, the business must gain profit to make it successful. According to Wallace and Pekel," attention to business ethics is necessary during times of fundamental change as the moral values that were not taken seriously are strongly questioned at that time."¹⁴

This theory mentions that the business holds a moral responsibility, and it is answerable to the concerns of stakeholders and the community. It emphasizes the philanthropic aspect of business rather than the profit and economy. It reiterates the obligations of the business towards the welfare of society. There must be equal importance rather than concentrating on the welfare of certain shareholders.

(B) Virtue ethics theory

The idea of moral virtue is the central aspect of this theory. It is essential to individual development, especially their moral character. "Virtue is quality or excellence that makes a thing good according to its nature, and moral virtues (versus intellectual virtues) are those

¹⁴ What is Business Ethics?, Free Management Library (2010), <https://managementhelp.org/blogs/business-ethics/2010/10/07/what-is-business-ethics/> (last visited Jan 29, 2022).

qualities that make a person morally or ethically excellent".¹⁵ *The virtue of virtue ethics as a framework takes the critical importance of these attributes for success in life and business seriously.*¹⁶ Though moral virtue and succeeding in a business by attaining profits are distinct, they are presumed to be connected and similar according to the concept of Virtue ethics. The indicators that determine business success are like that of attaining moral virtue. The concept of virtue ethics provides crucial importance to the persons than their actions.

It questions the character of the person than the morality of the action. According to the idea of virtue ethics, the actions of individuals might act as proof of a person's character, proof of what tendencies to behaviour that person has. Individuals' actions do not determine their character. It is said that moral virtue is achieved and appreciated as part of a good human being who is morally high, which is revealed in the person's habitual behaviour. A person is said to acquire moral virtue when he is persuaded to act generally in the way that are the individualities of a morally sound person. For instance, honesty is considered an attribute of a morally good person.

(C) Feminist ethics theory

There are various ideas on the feminist theories that are increasing due to women's involvement in the legal and corporate arena. The care-oriented approach has been viewed as an essential idea that explains the women's approach towards moral turpitude. According to Noddings,

"Women seem to approach moral problems by placing themselves as nearly as possible in concrete situations and assuming personal responsibility for the choices to be made. They define themselves in terms of [*caring*] and work their way through moral problems from the position of one-caring."¹⁷

Achieving gender equality through Corporate Social Responsibility has been questioned for an extended period. Though achieving gender equality is a part of the goal in many conglomerates, its action is not proper, and the reality has been changed. There are famous institutions that also work towards the same goal of gender equality. They are subsided with various other programs, and their importance is reduced eventually. There are various policies with catchy phrases like "Empower a woman, and you feed a community," "Gender economics is smart economics," and "Women are our most valuable untapped resource," but the effectiveness of

¹⁵Dennis Wittmer & Kevin O' Brien, *The Virtue of Virtue Ethics in Business and Business Education*, 11 Journal of Business Ethics Education 261–278 (2014).

¹⁶ *ibid*

¹⁷ Lloyd Edward Burton et al., *Feminist Theory, Professional Ethics, and Gender-Related Distinctions in Attorney Negotiating Styles*, Journal of Dispute Resolution 1 (1991).

these actions has always been a question.¹⁸ Even though women are in substantial decision-making roles today, it is still a long way.

V. NEED FOR AN IDEAL FRAMEWORK

Corporate social responsibility is a central aspect of corporate governance. Corporate social responsibility (CSR) is "defined as categories of economic, legal, ethical and discretionary activities of a business entity as adapted to the values and expectations of society".¹⁹ Costin defines corporate social responsibility as the "basic expectations of the company regarding initiatives that take the form of protection of public health, public safety, and the environment."²⁰ Costin relates the role of corporate leaders and Corporate Social Responsibility by mentioning leadership and support of important issues such as education, environment conservation, community services, industry improvement and business practices and the sharing of nonproprietary quality-related information. According to Porter and Kramer (2006), under the scrutiny of government bodies, activist shareholders, and the media, CSR has become "an inescapable priority for business leaders in every country."²¹ Corporate Social Responsibility in India has been defined under Section 2(c) of the Companies (Corporate Social Responsibility Policy Rules, 2014. According to this Section, Corporate Social Responsibility includes the programs and activities mentioned in the Schedule VII of the Companies Act, 2013 and the activities and programs recommended by the Corporate Social Responsibility committee.

The customers worldwide prefer and provide importance to the company's corporate social responsibility practices. Community involvement is a critical factor for various customers that confidence in a company and interests them to invest in a Company. They prefer companies that give importance to sustainable development and environment conservation. Thus the Indian corporations must provide importance to Corporate Social Responsibility and conduct their business ethically. They cannot ignore ethics for Corporate Social Responsibility and vice versa. The ignorance might lead to heavy loss and loss of customers, especially globally, which would hinder business expansion. Hence maintaining a balance between ethics and Corporate Social Responsibility is significant. Thus inclusion of ethics in the CSR practices might be a

¹⁸ Lauren McCarthy, *Empowering Women Through Corporate Social Responsibility: A Feminist Foucauldian Critique*, 27 Business Ethics Quarterly 603–631 (2017).

¹⁹ Brenda Joyner, Dinah Payne & Cecily Raiborn, *Building values, business ethics and corporate social responsibility into the Developing organization*, 7 Journal of Developmental Entrepreneurship 113–131 (2002).

²⁰ *ibid*

²¹ Michael E. Porter & Mark R. Kramer, *Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, Harvard Business Review, 2006, <https://hbr.org/2006/12/strategy-and-society-the-link-between-competitive-advantage-and-corporate-social-responsibility> (last visited Jan 29, 2022).

viable solution.

The inclusion of ethics in a company has many advantages. Ethics forms a basis for maintaining and attracting customers; if the company follows and incorporates more ethical practices, customers will gain trust in the company and get a lot of reliable customers. It is necessary to incorporate ethics as a part of a company's practices, especially as part of Corporate Social Responsibility. Following ethical practices helps the company maintain a good record and prevent fraud, preventing many legal issues. This saves the company's time, and the public will form a reasonable opinion about the company. The ethical practices attract customers and employees as they have a conducive work environment, making them more productive. Ethics cannot be made an integral part of a company's business without having a code. However, that will not be sufficient. The focus needs to shift from writing a detailed list of rules and principles designed to regulate conduct to leveraging a values-based code that fosters principled and ethical performance among employees, management, and executives. This should be the benchmark companies aspire to in compliance programs and organisational culture.

Organisational ethics can be categorised into four different types, they are:

- Exploitative
- Balanced
- Manipulative
- Hostile

These classifications are based on the profit gaining capacity of the company and maintaining their ethical standards simultaneously. The companies with balanced organisational ethics are said to be successful as they arrive at a perfect balance between gaining profit and maintaining ethical standards. Exploitative organisational ethics are least preferred as they do not maintain proper ethics and, at the same time, do not gain much profit. They do not have a conducive environment for the employees. The companies with manipulative organisational ethics gain profit but do not maintain proper ethical standards; thus, there is an imbalance. Companies with holistic organizational ethics have high ethical standards but do not profit, not interest the shareholders and investors.

The need for an ideal framework has been debated for a long time. The main issue in bringing a framework would be maintaining uniformity as the nature of business differ. Thus the nature of the organisation also differs. Thus the basic level of ethics that must be followed to make a business successful can be made mandatory by creating a framework. However, it is

cumbersome to check every company, and it is difficult to prove that the required level of ethics is not followed unless a complaint arises. Therefore there must be a proper code of conduct that is uniform, and there must be proper reports of adhering to the code.

VI. CONCLUSION

Ethics has been an essential aspect of the development and success of the company. Thus incorporating ethics and making it mandatory by creating a proper framework with checks and penalties will make this process simple and uniform. This would help to prevent fraud and maintain loyalty among customers. However, corporate ethics is an ever-evolving field and its simple inclusion into any code or making it mandatory would not suffice. It must be adopted and practised by every person associated with the company on an individual level. There must be proper steps taken to ensure that the framework is unbiased and that every industry can accommodate those policies in their corporate governance. Numerous organisations have worked tenaciously to incorporate ethical investigation into characterising their corporate governance culture with a means to social obligation and return. However, the number of organisations that have followed the ethical norms is also less. So adoption of ethical values on the individual level with oversight of the board is the best way possible. An approach that would benefit the company and maximise shareholder value could be the best ethical approach for any organisation.
