

Corporate Governance and Ethical Leadership

*Business Ethics Symposium:
The New Challenge for
Business Schools and Corporate Leaders*

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Aftermath of Scandal

- Executives believe scandals have permanently changed business landscape (Asia-88%; Europe-81%; North America-78%)
- 76% are improving internal controls
- 64% are reviewing relationships with auditors and accountants
- 55% are revising their codes of ethics
- Less than 20% believe new governance standards will improve ethical behavior

Source: Corporate Reputation Watch, 2003

Corporate Governance

- Formal system of accountability & control for organizational decisions & resources
- Major issues:
 - Shareholder rights
 - Executive compensation
 - Mergers & acquisitions
 - Board composition & structure
 - Auditing, control & risk management
 - CEO selection & executive succession plans



Models of Corporate Governance

- Shareholder model
 - Maximization of wealth for investors & owners
 - Developing & improving the formal system of performance accountability between management & the firm's shareholders
 - Making decisions based on what is best for investors
- Stakeholder model
 - Considers the interests of employees, suppliers, government agencies, communities & groups which with it interacts
 - Assumes a collaborative & relational approach to business

Ethical Leadership

- People-oriented
- Modeled through visible ethical actions and traits
- Focused on setting ethical standards and accountability
- Based on broad ethical awareness
- Indicative of a strong decision-making approach

Source: Trevino, Brown, & Hartman 2003

Models of Ethical Leadership

- Transactional
 - Implement required procedures and conduct
 - Protect individual rights
 - Ends justify the means
- Transformational
 - Build commitment and respect for values
 - Meet social obligations
 - Means justify the ends

Which Comes First: Governance or Ethical Leadership?



Board's Role: Ethics As A Business Goal

- Inducing ethical behavior and/or reducing unethical behavior are appropriate goals
- Ethics-related goals are no different from increasing profits or satisfying customers
- These goals must be on the corporate agenda

Board's Role: Ethics & Compliance Programs

- Expect top management to provide a plan for developing and maintaining an ethical culture
- Many organizations train employees in business ethics, but less than 30% train the board of directors
- Examine best practices and updates in ethical compliance

USSC Ad Hoc Advisory Group: Sentencing Guidelines Update

1. Emphasize the importance of an organizational culture that encourages a commitment to compliance with the law
2. Specify the responsibilities of an organization's governing authority and organizational leadership for compliance
3. Include training and dissemination of training materials and information within the definition of an "effective program"

Source: United States Sentencing Commission 2003

USSC Ad Hoc Advisory Group: Sentencing Guidelines Update

4. Add "periodic evaluation of the effectiveness of a program" to the requirement for monitoring and auditing systems
5. Provide for the conduct of ongoing risk assessments as part of the implementation of an "effective program"

Source: United States Sentencing Commission 2003

Executive's Role: Leader

- Establishes the ethical tone for the entire firm
- Responsible for corporate reputation
- Interaction of ethical leadership and corporate culture determines ethical value system of the firm
- Fundamental nexus between the board and firm's stakeholders

Executive's Role: Practices

- Cares about people and treats them with respect
- Practices values-based management
- Are consistent and predictable
- Acknowledges interests of multiple stakeholders
- Uses fairness criteria and other heuristics
- Does not tolerate ethical lapses



Future of Corporate Governance

- Embrace stakeholder model & ethical leadership principles and expectations
- Utilize a transparent approach & determine disclosure practices
- Develop company purpose statements that cover stakeholder interests
- Implement board self-assessment and stronger membership requirements
- Ask tough questions about controversial issues

Resources

- 2003 Corporate Reputation Watch survey: <http://www.corporatereputationwatch.com>
- Barbara Pagano and Elizabeth Pagano, *The Transparency Edge: How Credibility Can Make or Break You in Business* (McGraw-Hill, 2003)
- E-businessethics.com
- United States Sentencing Commission, Ad Hoc Advisory Group on Org. Sentencing Guidelines: <http://www.uscc.gov/corp/advgrprpt/advgrprpt.htm>
- Trevino, Brown & Hartman, "A Qualitative Investigation of Perceived Executive Ethical Leadership," *Human Relations* (January 2003).
