NIILM University

PRINCIPLES OF CORPORATE GOVERNANCE

Chapter 1

Corporate Governance

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, crors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

There has been renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability, since the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron Corporation and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in Australia are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

Other definitions

Corporate governance has also been defined as "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers."

- In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade crors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees.

Much of the contemporary interest in corporate governance is concerned with mitigation of the conflicts of interests between stakeholders.Ways of mitigating or preventing these conflicts of interests include the processes, customs, policies, laws, and institutions which have an impact on the way a company is controlled. An important theme of governance is the nature and extent of corporate accountability.

A related but separate thread of discussions focuses on the impact of a corporate governance system on economic efficiency, with a strong emphasis on shareholders' welfare. In large firms where there is a separation of ownership and management and no controlling shareholder, the principal–agent issue arises between upper-management (the "agent") which may have very different interests, and by definition considerably more information, than shareholders (the "principals"). The danger arises that rather than overseeing management on behalf of shareholders, the board of directors may become insulated from shareholders and beholden to management. This aspect is particularly present in contemporary public debates and developments in regulatory policy.(see regulation and policy regulation).

Economic analysis has resulted in a literature on the subject. One source defines corporate governance as "the set of conditions that shapes the ex post bargaining over the quasi-rents generated by a firm." The firm itself is modelled as a governance structure acting through the mechanisms of contract. Here corporate governance may include its relation to corporate finance.

Principles of corporate governance

Contemporary discussions of corporate governance tend to refer to principles raised in three documents released since 1990: The Cadbury Report (UK, 1992), the Principles of Corporate Governance (OECD, 1998 and 2004), the Sarbanes-Oxley Act of 2002 (US, 2002). The Cadbury and OECD reports present general principles around which businesses are expected to operate to assure proper governance. The Sarbanes-Oxley Act, informally referred to as Sarbox or Sox, is an attempt by the federal government in the United States to legislate several of the principles recommended in the Cadbury and OECD reports.

•Rights and equitable treatment of shareholders:Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.

•Interests of other stakeholders: Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, cr ors, suppliers, local communities, customers, and policy makers.

• Role and responsibilities of the board: The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.

• Integrity and ethical behavior: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

• Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

Corporate governance models around the world

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or Multistakeholder Model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. A related distinction is between market-orientated and network-orientated models of corporate governance.

Continental Europe

Some continental European countries, including Germany and the Netherlands, require a two-tiered Board of Directors as a means of improving corporate governance.[26] In the two-tiered board, the Executive Board, made up of company executives, generally runs day-to-day operations while the supervisory board, made up entirely of non-executive directors who represent shareholders and employees, hires and fires the members of the executive board, determines their compensation, and reviews major business decisions.See also Aktiengesellschaft.

India

India's SEBI Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." It has been suggested that the Indian approach is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

United States, United Kingdom

The so-called "Anglo-American model" of corporate governance emphasizes the interests of shareholders. It relies on a single-tiered Board of Directors that is normally dominated by non-executive directors elected by shareholders. Because of this, it is also known as "the unitary system". Within this system, many boards include some executives from the company (who are ex officio members of the board). Non-executive directors are expected to outnumber executive directors and hold key posts, including audit and compensation committees. The United States and the United Kingdom differ in one critical respect with regard to corporate governance: In the United Kingdom, the CEO generally does not also serve as Chairman of the Board, whereas in the US having the dual role is the norm, despite major misgivings regarding the impact on corporate governance.

In the United States, corporations are directly governed by state laws, while the exchange (offering and trading) of securities in corporations (including shares) is governed by federal legislation. Many US states have adopted the Model Business Corporation Act, but the dominant state law for publicly traded corporations is Delaware, which continues to be the place of incorporation for the majority of publicly traded corporations. Individual rules for corporations are based upon the corporate charter and, less authoritatively, the corporate bylaws. Shareholders cannot initiate changes in the corporate charter although they can initiate changes to the corporate bylaws.

Regulation

Legal environment – General

Corporations are created as legal persons by the laws and regulations of a particular jurisdiction. These may vary in many respects between countries, but a corporation's legal person status is fundamental to all jurisdictions and is conferred by statute. This allows the entity to hold property in its own right without reference to any particular real person. It also results in the perpetual existence that characterizes the modern corporation. The statutory granting of corporate existence may arise from general purpose legislation (which is the general case) or from a statute to create a specific corporation, which was the only method prior to the 19th century.

In addition to the statutory laws of the relevant jurisdiction, corporations are subject to common law in some countries, and various laws and regulations affecting business practices. In most jurisdictions, corporations also have a constitution that provides individual rules that govern the corporation and authorize or constrain its decision-makers. This constitution is identified by a variety of terms; in English-speaking jurisdictions, it is usually known as the Corporate Charter or the [Memorandum] and Articles of Association. The capacity of shareholders to modify the constitution of their corporation can vary substantially

The U.S. passed the Foreign Corrupt Practices Act (FCPA) in 1977, with subsequent modifications. This law made it illegal to bribe government officials and required corporations to maintain adequate accounting controls. It is enforced by the U.S. Department of Justice and the

Securities and Exchange Commission (SEC). Substantial civil and criminal penalties have been levied on corporations and executives convicted of bribery.

The UK passed the Bribery Act in 2010. This law made it illegal to bribe either government or private citizens or make facilitating payments (i.e., payment to a government official to perform their routine duties more quickly). It also required corporations to establish controls to prevent bribery.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in the wake of a series of high profile corporate scandals. It established a series of requirements that affect corporate governance in the U.S. and influenced similar laws in many other countries. The law required, along with many other elements, that:

- The Public Company Accounting Oversight Board (PCAOB) be established to regulate the auditing profession, which had been self-regulated prior to the law. Auditors are responsible for reviewing the financial statements of corporations and issuing an opinion as to their reliability.

- The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) attest to the financial statements. Prior to the law, CEO's had claimed in court they hadn't reviewed the information as part of their defense.

- Board audit committees have members that are independent and disclose whether or not at least one is a financial expert, or reasons why no such expert is on the audit committee.

- External audit firms cannot provide certain types of consulting services and must rotate their lead partner every 5 years. Further, an audit firm cannot audit a company if those in specified senior management roles worked for the auditor in the past year. Prior to the law, there was the real or perceived conflict of interest between providing an independent opinion on the accuracy and reliability of financial statements when the same firm was also providing lucrative consulting services.

Codes and guidelines

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect.

OECD principles

One of the most influential guidelines has been the OECD Principles of Corporate Governance—published in 1999 and revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations and more than 20 national corporate governance codes formed the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) to produce their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

- Auditing
- Board and management structure and process
- Corporate responsibility and compliance
- Financial transparency and information disclosure
- Ownership structure and exercise of control rights

Stock exchange listing standards

Companies listed on the New York Stock Exchange (NYSE) and other stock exchanges are required to meet certain governance standards. For example, the NYSE Listed Company Manual requires, among many other elements:

- Independent directors: "Listed companies must have a majority of independent directors...Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest." (Section 303A.01) An independent director is not part of management and has no "material financial relationship" with the company.

- Board meetings that exclude management: "To empower non-management directors to serve as a more effective check on management, the non-management directors of each listed company must meet at regularly scheduled executive sessions without management." (Section 303A.03)

- Boards organize their members into committees with specific responsibilities per defined charters. "Listed companies must have a nominating/corporate governance committee composed entirely of independent directors." This committee is responsible for nominating new members for the board of directors. Compensation and Audit Committees are also specified, with the latter subject to a variety of listing standards as well as outside regulations. (Section 303A.04 and others)

Chapter 2

Shareholders Agreement

A shareholders' agreement (sometimes referred to in the U.S. as a stockholders' agreement) is an agreement amongst the shareholders of a company.

In strict legal theory, the relationships amongst the shareholders and those between the shareholders and the company are regulated by the constitutional documents of the company;[citation needed] however, where there are a relatively small number of shareholders it is quite common in practice for the shareholders to supplement the constitutional document. There are a number of reasons why the shareholders may wish to supplement (or supersede) the constitutional documents of the company in this way:

- a company's constitutional documents are normally available for public inspection, whereas the terms of a shareholders' agreement, as a private law contract, are normally confidential between the parties.

- contractual arrangements are generally cheaper and less formal to form, administer, revise or terminate.

- the shareholders might wish to provide for disputes to be resolved by arbitration, or in the courts of a foreign country (meaning a country other than the country in which the company isincorporated). In some countries, corporate law does not permit such dispute resolution clauses to be included in the constitutional documents.

- greater flexibility; the shareholders may anticipate that the company's business requires regular changes to their arrangements, and it may be unwieldy to repeatedly amend the corporate constitution.

- corporate law in the relevant country may not provide sufficient protection for minority shareholders, who may seek to better protect their position by using a shareholders' agreement

- to provide mechanisms for removing minority shareholders which preserve the company as a going concern.

Risks

There are also certain risks which can be associated with putting a shareholders' agreement in place in some countries.

• In some countries, using a shareholders' agreement can constitute a partnership, which can have unintended tax consequences, or result in liability attaching to shareholders in the event of a bankruptcy.

• Where the shareholders' agreement is inconsistent with the constitutional documents, the efficacy of the parties' intended arrangement can be undermined.

• Countries with notarial formalities, where notarial fees are set by the value of the subject matter, parties can find that their agreement is subject to prohibitively high notarial costs, which, if they fail to pay, would result in the agreement being unenforceable.

• In certain circumstances, a shareholders' agreement can be put forward as evidence of a conspiracy and/or monopolistic practices.

Common characteristics

Shareholders' agreements obviously vary enormously between different countries and different commercial fields. However, in a characteristic joint venture or business start-up, a shareholders' agreement would normally be expected to regulate the following matters:

- regulating the ownership and voting rights of the shares in the company, including
- Lock-down provisions
- restrictions on transferring shares, or granting security interests over shares
- pre-emption rights and rights of first refusal in relation to any shares issued by the company (often called a buy-sell agreement)
- "tag-along" and "drag-along" right

- minority protection provision
- control and management of the company, which may include
- power for certain shareholders to designate individual for election to the board of directors
- imposing super-majority voting requirements for "reserved matters" which are of key importance to the parties
- imposing requirements to provide shareholders with accounts or other information that they might not otherwise be entitled to by law
- making provision for the resolution of any future disputes between shareholders, including
- deadlock provisions
- dispute resolution provisions
- protecting the competitive interests of the company which may include
- restrictions on a shareholder's ability to be involved in a competing business to the company
- restrictions on a shareholder's ability to poach key employees of the company
- key terms with suppliers or customers who are also shareholders
- In addition, shareholders agreements will often make provision for the following:
- the nature and amount of initial contribution (whether capital contribution or other) to the company
- the proposed nature of the business
- how any future capital contributions or financing arrangements are to be made
- the governing law of the shareholders' agreement

- ethical practices or environmental practices
- allocation of key roles or responsibilities

Registration

In most countries, registration of a shareholders' agreement is not required for it to be effective. Indeed, it is the perceived greater flexibility of contract law over corporate law that provides much of the raison d'être for shareholders' agreements.

This flexibility, however, can give rise to conflicts between a shareholders' agreement and the constitutional documents of a company. Although laws differ across countries, in general most conflicts are resolved as follows:

- as against outside parties, only the constitutional documents regulate the company's powers and proceedings.
- as between the company and its shareholders, a breach of the shareholders' agreement which does not breach the constitutional documents will still be a valid corporate act, but it may sound in damages against the party who breaches the agreement.
- as between the company and its shareholders, a breach of the constitutional documents which does not breach the shareholders' agreement will nonetheless usually be an invalid corporate act.
- characteristically, courts will not grant an injunction or award specific performance in relation to a shareholders' agreement where to do so would be inconsistent with the company's constitutional documents.

Other guidelines

The investor-led organisation International Corporate Governance Network (ICGN) was set up by individuals centered around the ten largest pension funds in the world 1995. The aim is to promote global corporate governance standards. The network is led by investors that manage 18 trillion dollars and members are located in fifty different countries. ICGN has developed a suite of global guidelines ranging from shareholder rights to business ethics.The World Business

Council for Sustainable Development (WBCSD) has done work on corporate governance, particularly on accountability and reporting, and in 2004 released Issue Management Tool: Strategic challenges for business in the use of corporate responsibility codes, standards, and frameworks. This document offers general information and a perspective from a business association/think-tank on a few key codes, standards and frameworks relevant to the sustainability agenda.

In 2009, the International Finance Corporation and the UN Global Compact released a report, Corporate Governance - the Foundation for Corporate Citizenship and Sustainable Business, linking the environmental, social and governance responsibilities of a company to its financial performance and long-term sustainability.

Most codes are largely voluntary. An issue raised in the U.S. since the 2005 Disney decision[39] is the degree to which companies manage their governance responsibilities; in other words, do they merely try to supersede the legal threshold, or should they create governance guidelines that ascend to the level of best practice. For example, the guidelines issued by associations of directors, corporate managers and individual companies tend to be wholly voluntary but such documents may have a wider effect by prompting other companies to adopt similar practices.

History

In the 20th century in the immediate aftermath of the Wall Street Crash of 1929 legal scholars such as Adolf Augustus Berle, Edwin Dodd, and Gardiner C. Means pondered on the changing role of the modern corporation in society. From the Chicago school of economics, Ronald Coase introduced the notion of transaction costs into the understanding of why firms are founded and how they continue to behave.

US expansion after World War II through the emergence of multinational corporations saw the establishment of the managerial class. Studying and writing about the new class were several Harvard Business School management professors: Myles Mace (entrepreneurship), Alfred D. Chandler, Jr. (business history), Jay Lorsch (organizational behavior) and Elizabeth MacIver (organizational behavior). According to Lorsch and MacIver "many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors."

In the 1980s, Eugene Fama and Michael Jensen established the principal–agent problem as a way of understanding corporate governance: the firm is seen as a series of contracts.

Over the past three decades, corporate directors' duties in the U.S. have expanded beyond their traditional legal responsibility of duty of loyalty to the corporation and its shareholders.

In the first half of the 1990s, the issue of corporate governance in the U.S. received considerable press attention due to the wave of CEO dismissals (e.g.: IBM, Kodak, Honeywell) by their boards. The California Public Employees' Retirement System (CalPERS) led a wave of institutional shareholder activism (something only very rarely seen before), as a way of ensuring that corporate value would not be destroyed by the now traditionally cozy relationships between the CEO and the board of directors (e.g., by the unrestrained issuance of stock options, not infrequently back dated).

In the early 2000s, the massive bankruptcies (and criminal malfeasance) of Enron and Worldcom, as well as lesser corporate scandals, such as Adelphia Communications, AOL, Arthur Andersen, Global Crossing, Tyco, led to increased political interest in corporate governance. This is reflected in the passage of the Sarbanes-Oxley Act of 2002. Other triggers for continued interest in the corporate governance of organizations included the financial crisis of 2008/9 and the level of CEO pay

East Asia

In 1997, the East Asian Financial Crisis severely affected the economies of Thailand, Indonesia, South Korea, Malaysia, and the Philippines through the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies.

Parties to corporate governance

Key parties involved in corporate governance include stakeholders such as the board of directors, management and shareholders. External stakeholders such as cr ors, auditors, customers, suppliers, government agencies, and the community at large also exert influence. The agency view of the corporation posits that the shareholder forgoes decision rights (control) and entrusts the manager to act in the shareholders' best (joint) interests. Partly as a result of this separation between the two investors and managers, corporate governance mechanisms include a system of controls intended to help align managers' incentives with those of shareholders. Agency concerns (risk) are necessarily lower for a controlling shareholder.

Responsibilities of the board of directors

Former Chairman of the Board of General Motors John G. Smale wrote in 1995: "The board is responsible for the successful perpetuation of the corporation. That responsibility cannot be relegated to management." A board of directors is expected to play a key role in corporate governance. The board has responsibility for: CEO selection and succession; providing feedback to management on the organization's strategy; compensating senior executives; monitoring financial health, performance and risk; and ensuring accountability of the organization to its investors and authorities. Boards typically have several committees (e.g., Compensation, Nominating and Audit) to perform their work.

The OECD Principles of Corporate Governance (2004) describe the responsibilities of the board; some of these are summarized below:

- Board members should be informed and act ethically and in good faith, with due diligence and care, in the best interest of the company and the shareholders.
- Review and guide corporate strategy, objective setting, major plans of action, risk policy, capital plans, and annual budgets.
- Oversee major acquisitions and divestitures.
- Select, compensate, monitor and replace key executives and oversee succession planning.
- Align key executive and board remuneration (pay) with the longer-term interests of the company and its shareholders.
- Ensure a formal and transparent board member nomination and election process.
- Ensure the integrity of the corporations accounting and financial reporting systems, including their independent audit.

- Ensure appropriate systems of internal control are established.
- Oversee the process of disclosure and communications.
- Where committees of the board are established, their mandate, composition and working procedures should be well-defined and disclosed.

Stakeholder interests

All parties to corporate governance have an interest, whether direct or indirect, in the financial performance of the corporation. Directors, workers and management receive salaries, benefits and reputation, while investors expect to receive financial returns. For lenders, it is specified interest payments, while returns to equity investors arise from dividend distributions or capital gains on their stock. Customers are concerned with the certainty of the provision of goods and services of an appropriate quality; suppliers are concerned with compensation for their goods or services, and possible continued trading relationships. These parties provide value to the corporation in the form of financial, physical, human and other forms of capital. Many parties may also be concerned with corporate social performance.

A key factor in a party's decision to participate in or engage with a corporation is their confidence that the corporation will deliver the party's expected outcomes. When categories of parties (stakeholders) do not have sufficient confidence that a corporation is being controlled and directed in a manner consistent with their desired outcomes, they are less likely to engage with the corporation. When this becomes an endemic system feature, the loss of confidence and participation in markets may affect many other stakeholders, and increases the likelihood of political action. There is substantial interest in how external systems and institutions, including markets, influence corporate governance.

Control and ownership structures

Control and ownership structure refers to the types and composition of shareholders in a corporation. In some countries such as most of Continental Europe, ownership is not necessarily equivalent to control due to the existence of e.g. dual-class shares, ownership pyramids, voting coalitions, proxy votes and clauses in the articles of association that confer additional voting rights to long-term shareholders. Ownership is typically defined as the ownership of cash flow rights whereas control refers to ownership of control or voting rights. Researchers often "measure" control and ownership structures by using some observable measures of control and ownership concentration or the extent of inside control and ownership. Some features or types of control and ownership structure involving corporate groups include pyramids, cross-shareholdings, rings, and webs. German "concerns" (Konzern) are legally recognized corporate groups with complex structures. Japanese keiretsu and South Korean chaebol (which tend to be family-controlled) are corporate groups which consist of complex interlocking business relationships and shareholdings. Cross-shareholding are an essential feature of keiretsu and chaebol groups. Corporate engagement with shareholders and other stakeholders can differ substantially across different control and ownership structures.

Family control

Family interests dominate ownership and control structures of some corporations, and it has been suggested the oversight of family controlled corporation is superior to that of corporations "controlled" by institutional investors (or with such diverse share ownership that they are controlled by management). A recent study by Cr Suisse found that companies in which "founding families retain a stake of more than 10% of the company's capital enjoyed a superior performance over their respective sectorial peers." Since 1996, this superior performance amounts to 8% per year. Forget the celebrity CEO. "Look beyond Six Sigma and the latest technology fad. One of the biggest strategic advantages a company can have is blood ties," according to a Business Week study

Diffuse shareholders

The significance of institutional investors varies substantially across countries. In developed Anglo-American countries (Australia, Canada, New Zealand, U.K., U.S.), institutional investors dominate the market for stocks in larger corporations. While the majority of the shares in the Japanese market are held by financial companies and industrial corporations, these are not institutional investors if their holdings are largely with-on group.[citation needed]

The largest pools of invested money (such as the mutual fund 'Vanguard 500', or the largest investment management firm for corporations, State Street Corp.) are designed to maximize the benefits of diversified investment by investing in a very large number of different corporations with sufficient liquidity. The idea is this strategy will largely eliminate individual firm financial or other risk and. A consequence of this approach is that these investors have relatively little interest in the governance of a particular corporation. It is often assumed that, if institutional investors pressing for will likely be costly because of "golden handshakes" or the effort required, they will simply sell out their interest.

Mechanisms and controls

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. There are both internal monitoring systems and external monitoring systems. Internal monitoring can be done, for example, by one (or a few) large shareholder(s) in the case of privately held companies or a firm belonging to a business group. Furthermore, the various board mechanisms provide for internal monitoring. External monitoring of managers' behavior, occurs when an independent third party (e.g. the external auditor) attests the accuracy of information provided by management to investors. Stock analysts and debt holders may also conduct such external monitoring. An ideal monitoring and control system should regulate both motivation and ability, while providing incentive alignment toward corporate goals and objectives. Care should be taken that incentives are not so strong that some individuals are tempted to cross lines of ethical behavior, for example by manipulating revenue and profit figures to drive the share price of the company up.

Internal corporate governance controls

Internal corporate governance controls monitor activities and then take corrective action to accomplish organisational goals. Examples include:

- Monitoring by the board of directors: The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance.[54] Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, ex ante. It could be argued, therefore, that executive directors look beyond the financial criteria.

- Internal control procedures and internal auditors: Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting

- Balance of power: The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

- Remuneration: Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such asshares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior.

- Monitoring by large shareholders and/or monitoring by banks and other large cr ors: Given their large investment in the firm, these stakeholders have the incentives, combined with the right degree of control and power, to monitor the management.

- In publicly traded U.S. corporations, boards of directors are largely chosen by the President/CEO and the President/CEO often takes the Chair of the Board position for his/herself (which makes it much more difficult for the institutional owners to "fire" him/her). The practice of the CEO also being the Chair of the Board is fairly common in large American corporations.

- While this practice is common in the U.S., it is relatively rare elsewhere. In the U.K., successive codes of best practice have recommended against duality.

External corporate governance controls

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Examples include:

- Competition
- Debt covenants
- Demand for and assessment of performance information (especially financial statements)
- Government regulations
- Managerial labour market
- Media pressure
- Takeovers

Financial reporting and the independent auditor

The board of directors has primary responsibility for the corporation's external financial reporting functions. The Chief Executive Officer and Chief Financial Officer are crucial participants and boards usually have a high degree of reliance on them for the integrity and supply of accounting information. They oversee the internal accounting systems, and are dependent on the corporation'saccountants and internal auditors.

Current accounting rules under International Accounting Standards and U.S. GAAP allow managers some choice in determining the methods of measurement and criteria for recognition of various financial reporting elements. The potential exercise of this choice to improve apparent performance (see creative accounting and earnings management) increases the information risk for users. Financial reporting fraud, including non-disclosure and deliberate falsification of values also contributes to users' information risk. To reduce this risk and to enhance the perceived integrity of financial reports, corporation financial reports must be audited by an independent external auditor who issues a report that accompanies the financial statements.

One area of concern is whether the auditing firm acts as both the independent auditor and management consultant to the firm they are auditing. This may result in a conflict of interest which places the integrity of financial reports in doubt due to client pressure to appease management. The power of the corporate client to initiate and terminate management consulting services and, more fundamentally, to select and dismiss accounting firms contradicts the concept of an independent auditor. Changes enacted in the United States in the form of the Sarbanes-Oxley Act (following numerous corporate scandals, culminating with the Enron scandal) prohibit accounting firms from providing both auditing and management consulting services. Similar provisions are in place under clause 49 of Standard Listing Agreement in India.

Chapter 3

Economic efficiency

In economics, the term economic efficiency refers to the use of resources so as to maximize the production of goods and services. An economic system is said to be more efficient than another (in relative terms) if it can provide more goods and services for society without using more resources. In absolute terms, a situation can be called economically efficient if:

- No one can be made better off without making someone else worse off (commonly referred to as Pareto efficiency).
- No additional output can be obtained without increasing the amount of inputs.
- Production proceeds at the lowest possible per-unit cost.

These definitions of efficiency are not exactly equivalent, but they are all encompassed by the idea that a system is efficient if nothing more can be achieved given the resources available.

Theory

Efficiency = product/(input resources+ input labor + input tool)

It can refer to mechanical efficiency formula:

Mechanical efficiency refers to the ratio of useful work and total energy, expressed with symbols η is calculated as

$\eta = W \text{ useful} / W \text{ total} * 100\%$

But for the working efficiency of the individual, we always think that is related to time. In fact, personal work of economic efficiency is only related to the person's individual ability, before the ability did not change, people work in the economic efficiency is a constant. This is just like before the mechanical structure has not changed, its mechanical efficiency is a constant.

The efficiency is the ratio of a person's output and input.

Application

variety of products on the market have exchange rate, we call for general exchange coefficient.

Exchange coefficient = product 1/ product 2 (2-4-3)

According to the previous formula

efficiency = product/(input resources+ input labor + input tool)

If the two products need put into the same (labor, resources ,tool).

efficiency product 1 = exchange coefficient* efficiency product 2

That is to say, we can know that we are in the same input by exchanging coefficient which mode of production is the maximum economic efficiency.

Because in every country. Money expressed the exchange coefficients of each product exchange coefficient. Also expressed in the form of price system, and so in market economy countries, everyone can find their economic efficiency of the largest production mode through market prices.

Old Theory

There are two main strains in economic thought on economic efficiency, which respectively emphasize the distortions created by governments (and reduced by decreasing government involvement) and the distortions created by markets (and reduced by increasing government involvement). These are at times competing, at times complementary – either debating the overall level of government involvement, or the effects of specific government involvement. Broadly speaking, this dialog is referred to as Economic liberalism or neoliberalism, though these terms are also used more narrowly to refer to particular views, especially advocating laissez faire.

Further, there are differences in views on microeconomic versus macroeconomic efficiency, some advocating a greater role for government in one sphere or the other.

Allocative and productive efficiency

A market can be said to have allocative efficiency if the price of a product that the market is supplying is equal to the value consumers place on it, represented by marginal cost. Because productive resources are scarce, the resources must be allocated to various Industries in just the right amounts, otherwise too much or too little output gets produced. (Thomas. Government Regulation of Business. 2013 McGraw-Hill.) When drawing diagrams for firms, allocative efficiency is satisfied if the equilibrium is at the point where marginal cost is equal to average revenue. This is the case for the long run equilibrium of perfect competition.

Productive efficiency is when units of goods are being supplied at the lowest possible average total cost. When drawing diagrams for firms, this condition is satisfied if the equilibrium is at the minimum point of the ATC curve. This is again the case for the long run equilibrium of perfect competition.

Mainstream views

The mainstream view is that market economies are generally believed to be more efficient than other known alternatives and that government involvement is necessary at the macroeconomic level (via fiscal policy and monetary policy) to counteract the economic cycle – following Keynesian economics. At the microeconomic level there is debate about how to maximize efficiency, with some advocating laissez faire, to remove government distortions, while others advocate regulation, to reduce market failures and imperfections, particularly via internalizing externalities.

The first fundamental welfare theorem provides some basis for the belief in efficiency of market economies, as it states that any perfectly competitive market equilibrium is Pareto efficient. Strictly speaking, however, this result is only valid in the absence of market imperfections, which are significant in real markets. Furthermore, Pareto efficiency is a minimal notion of optimality and does not necessarily result in a socially desirable distribution of resources, as it makes no statement about equality or the overall well-being of a society.

Schools of thought

Advocates of limited government, in the form laissez faire (little or no government role in the economy) follow from the 19th century philosophical tradition classical liberalism, and are particularly associated with the mainstream economic schools of classical economics (through the 1870s) and neoclassical economics (from the 1870s onwards), and with the heterodox Austrian school.

Advocates of an expanded government role follow instead in alternative streams of progressivism; in the Anglosphere (English-speaking countries, notably the United States, United Kingdom, Canada, Australia and New Zealand) this is associated with institutional economics and, at the macroeconomic level, with Keynesian economics. In Germany the guiding philosophy isOrdoliberalism, in the Freiburg School of economics.

Microeconomic

Microeconomic reform are policies that aim to reduce economic distortions via deregulation, and increase economic efficiency. However, there is no clear theoretical basis for the belief that removing a market distortion will always increase economic efficiency. The Theory of the Second Best states that if there is some unavoidable market distortion in one sector, a move toward greater market perfection in another sector may actually decrease efficiency.

Criteria

There are several alternate criteria for economic efficiency, these include:

- Pareto efficiency
- Kaldor-Hicks efficiency
- X-inefficiency
- Allocative efficiency
- Distributive efficiency
- Dynamic efficiency

- Optimisation of a social welfare function
- Productive efficiency
- Utility maximization

For applications of these principles see:

- Efficient-market hypothesis
- Microeconomic reform
- Production theory basics
- Welfare economics

Competing goals

Efficiency is but one of many vying goals in an economic system, and different notions of efficiency may be complementary or may be at odds. Most commonly, efficiency is contrasted or paired with morality, particularly liberty and justice. Some economic policies may be seen as increasing efficiency, but at the cost to liberty or justice, while others may be argued to both increase efficiency and be more free or just. There is debate on what effects specific policies have, which goals should be pursued, the relative weights that should be placed on different goals, and which trade-offs should be made.

For example, some advocates of laissez faire (such as classical liberalism in the 19th century and Objectivism in the 20th century) argue that such economies protect property rights and are thus both free and just, regardless of whether or not they are more efficient, though advocates also generally believe that laissez faire economies are more efficient.

Others argue that laissez faire leads to concentration of power and thus curtails liberty and reduces competition, and leads to unjust distribution of income and wealth, regardless of whether it increases efficiency, for example in the early 20th century American progressive movement – some (such as the Freiburg school) argue that laissez faire decreases efficiency in addition to being unfree and unjust, while others argue that government involvement may reduce efficiency, but that this is an acceptable cost for the increase in liberty and justice.

In welfare economics, trade-offs between efficiency and distributive justice, particularly in redistribution – to the extent that a certain policy decreases efficiency – is often visualized by the metaphor of the leaky bucket, imagining income or wealth as water moved between individuals, and inefficiency as leakage. Opponents of redistribution argue that redistribution is not only inefficient (the bucket leaks), but unjust (income or wealth should not be redistributed by the government at all, but rather the market alone should decide distribution).

Systemic problems of corporate governance

- Demand for information: In order to influence the directors, the shareholders must combine with others to form a voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.
- Monitoring costs: A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMH) asserts that financial markets are efficient), which suggests that the small shareholder will free ride on the judgments of larger professional investors.
- Supply of accounting information: Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process.

Debates in corporate governance

Executive pay

Increasing attention and regulation (as under the Swiss referendum "against corporate Rip-offs" of 2013) has been brought to executive pay levels since the financial crisis of 2007–2008. Research on the relationship between firm performance and executive compensation does not identify consistent and significant relationships between executives' remuneration and firm performance. Not all firms experience the same levels of agency conflict, and external and internal monitoring devices may be more effective for some than for others. Some researchers have found that the largest CEO performance incentives came from ownership of the firm's shares, while other researchers found that the relationship between share ownership and firm performance was dependent on the level of ownership. The results suggest that increases in ownership above 20% cause management to become more entrenched, and less interested in the welfare of their shareholders.

Some argue that firm performance is positively associated with share option plans and that these plans direct managers' energies and extend their decision horizons toward the long-term, rather than the short-term, performance of the company. However, that point of view came under substantial criticism circa in the wake of various security scandals including mutual fund timing episodes and, in particular, the backdating of option grants as documented by University of Iowa academic Erik Lie and reported by James Blander and Charles Forelle of the Wall Street Journal.

Even before the negative influence on public opinion caused by the 2006 backdating scandal, use of options faced various criticisms. A particularly forceful and long running argument concerned the interaction of executive options with corporate stock repurchase programs. Numerous authorities (including U.S. Federal Reserve Board economist Weisbenner) determined options may be employed in concert with stock buybacks in a manner contrary to shareholder interests. These authors argued that, in part, corporate stock buybacks for U.S. Standard & Poors 500 companies surged to a $500 billion annual rate in late 2006 because of the impact of options. A compendium of academic works on the option/buyback issue is included in the study Scandal by author M. Gumport issued in 2006.

A combination of accounting changes and governance issues led options to become a less popular means of remuneration as 2006 progressed, and various alternative implementations of buybacks surfaced to challenge the dominance of "open market" cash buybacks as the preferred means of implementing a share repurchase plan.

Separation of Chief Executive Officer and Chairman of the Board roles

Shareholders elect a board of directors, who in turn hire a Chief Executive Officer (CEO) to lead management. The primary responsibility of the board relates to the selection and retention of the CEO. However, in many U.S. corporations the CEO and Chairman of the Board roles are held by the same person. This creates an inherent conflict of interest between management and the board.

Critics of combined roles argue the two roles should be separated to avoid the conflict of interest. Advocates argue that empirical studies do not indicate that separation of the roles improves stock market performance and that it should be up to shareholders to determine what corporate governance model is appropriate for the firm.

In 2004, 73.4% of U.S. companies had combined roles; this fell to 57.2% by May 2012. Many U.S. companies with combined roles have appointed a "Lead Director" to improve independence of the board from management. German and UK companies have generally split the roles in nearly 100% of listed companies. Empirical evidence does not indicate one model is superior to the other in terms of performance. However, one study indicated that poorly performing firms tend to remove separate CEO's more frequently than when the CEO/Chair roles are combined.

Chapter 4

Philosophy of business

The Development of management theory and philosophy considers the fundamental principles that underlie the formation and operation of a business enterprise; the nature and purpose of a business, for example, is it primarily property or a social institution; its role in society; and the moral obligations that pertain to it. The subject is important to business and management, and is closely related to business ethics and political economy. It is influenced significantly by philosophy, ethics, and economic theory.

One must draw an important distinction between the philosophy of business and business philosophy, which is an appellation that one often hears in the business world. More often than not, the latter designation is intended to denote a way of doing business or a business outlook, a popular use of the term philosophy, instead of its more formal, academic meaning, using the concepts and methods employed by philosophers. The latter meaning applies to the philosophy of business in this article. The phrase philosophy of business also might be used in the same way asbusiness philosophy, for example, "Risk taking represents my philosophy of business." However, this is not the same sense that philosophy is used in this article.

Development of Management Theory and Philosophy

Despite the fact that business touches nearly every aspect of our lives, few thinkers have shown an interest in it from a rules or philosophical perspective until relatively recently. Indeed, few philosophers can be said to have paid much attention to the business enterprise, itself, prior to the latter part of the 20th century. Many philosophers tended to look askance at commercial activity, believing, as Plato did, that only the worst sort of people are involved in such matters. Plato is not unlike many academics throughout history, even today, who tend to think of business as a necessary evil in society, and not as something worthy of serious philosophical consideration.

Although there have been few "philosophers of business", per se, business and economics has not developed in a vacuum. It is built on many tacit philosophical principles and assumptions that we can examine. As a general rule, business practitioners and theorists tend to accept the principles that are current in their society. In the European Middle Ages, for example, the dominant Christian influence resulted in a pricing practice known as just price, and in the Enlightenment the dominant view of economic decision making was one of rationality.

The formative years in the development of the modern philosophy of business and economics was the 17th and 18th century. At that time, thinkers like Hobbes, Locke, Rousseau, Shaftesbury, and Smith created the intellectual foundation upon which modern business and capitalism was built. A basic principle subsumed within business practice and economic theory alike is the notion of free will. Thomas Hobbes, John Locke, and Jean-Jacques Rousseau all accepted that we are free moral agents, able to make decisions, control our own destiny, and engage in a social contract. This notion would later be celebrated in the idea of the entrepreneur, someone that freely decides to pursue a risky venture in the hope of receiving great rewards. It is also at the core ofutility theory, a model of consumer behaviour in economics in which consumers freely choose what to purchase.

Another philosophic principle that would become part of business theory and practice is rationality. The general philosophic predilection of the enlightenment was that people were fundamentally rational. Philosophers such as René Descartes and Spinoza had built whole systems of thought on this assumption. Capitalism would do the same. For two hundred years economics was founded on the assumption of Homo economicus. This assumption has recently been challenged by Herbert A. Simon, among others.

Another key philosophic assumption is atomism. It was John Locke's view of society as an aggregation of independent, autonomous individuals, rather than Jean-Jacques Rousseau's vision of society as an organic collective that would become an integral part of business philosophy. The key ethical unit is the individual. Social institutions are merely constructs that individuals can use for their own purposes. Many years later, Milton Friedman used this assumption in arguing that corporations have no moral responsibility because, he contended, they are not individuals capable of responding to moral claims. Only the individuals within the business enterprise have a moral responsibility.

Modern business practice and theory developed in the age of scientific discovery, and this gave it a mechanistic orientation. In particular, Newton had just discovered classical physics. This would influence business and economics in ways that we are just beginning to understand. Early writers dealing with economic topics, such as Adam Smith, borrowed many of their techniques and terminology from classical physics. They would use terms like "equilibrium", "labor force", "elasticity", and "income accelerator". Today a few theorists are starting to question the mechanistic approach and model business on biological principles or chaos theory. Newton's law of inertia has found its way into marketing where it is claimed that consumers will continue in their current state unless they are encouraged to act otherwise. Thus advertising is claimed to perform the valuable role of helping people experience a more variegated and interesting life.

John Locke also contributed an important attitude towards the private ownership of property. He claimed that individuals have certain inalienable, natural rights. One of these is the right of ownership. He said that if we toil on the land and mix our sweat with the soil, we become the rightful owners of the land. This argument was extended to other assets including the factors of production, a conclusion that many, including Karl Marx, would challenge.

Another key concept that underlies modern business is ethical egoism. This states that the core moral obligation is to oneself. Thomas Hobbes saw all action as motivated out of self-interest. A group of philosophers including Mandeville, Butler, Shaftsebury, Hutcheson, and Smith (sometimes referred to as the "enlightened self-interest school") developed this into one of the core concepts of modern business theory. Bernard Mandeville claimed that private vices are actually public benefits. In The Fable of the Bees (1714) he laments that the "bees of social virtue are buzzing in mans bonnet". Civilized man has stigmatized his private appetites and the result is the retardation of the common good. Bishop Butler claimed that pursuing the public good was the best way of advancing one's own good since the two were necessarily identical. Lord Shaftesbury turned the convergence of public and private good around, claiming that acting in accordance with one's self-interest will produce socially beneficial results. An underlying unifying force that Shaftesbury called the "Will of Nature" maintains equilibrium, congruency, and harmony. This force, if it is to operate freely, requires the individual pursuit of rational self-interest, and the preservation and advancement of the self. Francis Hutcheson also accepted this convergence between public and private interest, but he attributed the mechanism, not to rational self-interest, but to personal intuition which he called a "moral sense". Adam Smith developed a version of this general principle in which six psychological motives combine in each individual to produce the common good. He called it the invisible hand. In The Theory of Moral Sentiments, vol II, page 316, he says: By acting according to the dictates of our moral faculties, we necessarily pursue the most effective means for promoting the happiness of mankind. Since Smith's time, the principle of the invisible hand has been further incorporated into economic theory. Léon Walras developed a four equation general equilibrium model which concludes that individual self-interest operating in a competitive market place produce the unique conditions under which a society's total utility is maximized. Vilfredo Pareto used an edgeworth box contact line to illustrate a similar social optimality.

A link can also be made between utilitarianism and the fundamental principles of the philosophy of business, however this is more theoretical than practical. Economists use utility theory to model human actions. Like Jeremy Bentham, modern economists assume that people are hedonists, that is they prefer more satisfaction to less satisfaction. The amount of satisfaction can be expressed in terms of the utility a person derives from the satisfaction. Social welfare functions used in modern welfare economics are an outgrowth of John Stuart Mill's utilitarian calculation of obtaining the greatest good for the greatest number. The grounding of business principles on teleological ethics has been challenged by many deontological philosophers. John Rawls' maxmin criterion also provides an alternative.

Modern philosophers of business

It is fair to say that most modern philosophers of business are involved in other philosophical or scholarly pursuits, and that they come to the philosophy of business as a sub-specialty, or only indirectly because it relates to another area of interest. Thus, they are primarily philosophers dealing with other subjects, economists, or business management theorists. If one were to examine the philosophy departments in most universities, today, one would find precious few courses in the philosophy of business (as opposed to a growing number of business ethics or applied ethics courses). There are indications that a growing number of philosophers with formal training in academic philosophy will come to specialize in the philosophy of business.

Perhaps the best known modern philosopher of business is Peter Drucker, whose publications have had a profound influence on management and organizational theory, generally, and on how we think of the business enterprise. More often than not, people who think about business issues are considering it from an applied perspective, which is to say, what is the best or most effective means of transacting commerce or managing the enterprise, with some goal in mind, usually profitability, improving employee relations, or marketing. While Drucker has dealt with these issues and many more in numerous publications over his long life, he also inquires into the principles and concepts that underlie commercial activity and organizational structure, and he asks what ought the mission of a business to be, and, in particular, how can we reconcile a business mission with conflicting interests in the marketplace and society.

One of the most frequently discussed topics is the matter of organizational change in a complex environment. Paul R. Lawrence has dealt primarily with organizational change, organization design, and the relationship between the structural characteristics of complex organizations and the technical, market and other conditions of their immediate environment. His 1967 book, Organization and Environment (written with Professor Jay Lorsch), added contingency theory to the vocabulary of students of organizational behavior.

Other philosophers of business, for example, Geoffrey Klempner, are principally interested in examining how business is even possible, which is to say, how can an enterprise function in society as a whole. Klempner states that theories of ethics and business are often at odds, and that one might even have to suspend the normal ethical considerations that would apply outside of business in order for a business to be possible. This is reminiscent of Albert Z. Carr's famous and controversial Harvard Business Review article on bluffing, where he said business was similar to playing poker, and that deception is a necessary part of business.

Of course, there is a close relationship between the philosophy of business and business ethics. Philosophers specializing in business ethics are primarily interested in how business people ought to conduct themselves in the marketplace and in society. Philosopher Norman E. Bowie adopts Kant's three versions of the categorical imperative for ensuring ethical business conduct, and he pays particular attention to the third variation, whereby the people within a business must be seen as a kingdom of ends, and not merely treated as means to an end.

The "invisible hand" is a favorite metaphor for practitioners of modern-day Western capitalism, the ideology driving globalization and, for the most part, business as we know it today. What many of the bottom-line fundamentalists may ignore is the degree to which the so-called "free market" has been skewed and maneuvered in ways Adam Smith never envisioned. Thus the question of ethics and conscience runs deeper yet. With exponential increases in government laws, regulations and court decisions regarding business in the past century, ethical practice has morphed from doing "the right thing" as conscience would dictate to doing what complies with the law or isn't explicitly illegal. Thus there's been a gradual relaxation of internal moral compass and greater reliance on external parameters, as in "if it isn't illegal, it must be all right", as well as a new skillset in finding "legal loopholes" in stretching the boundaries of compliance.

Some important philosophical topics

The purpose of a business

Most would argue that the main purpose of a business is to maximize profits for its owners, or in the case of a publicly traded company, its stockholders. The late economist Milton Friedman was a proponent of this view. Others would say that its principal purpose is to serve the interests of a larger group of stakeholders, including employees, customers, and even society as a whole. Most philosophers would agree, however, that business activities ought to comport with legal regulations.

Anu Aga, ex-chairperson of Thermax Limited, once said, "We survive by breathing but we can't say we live to breathe. Likewise, making money is very important for a business to survive, but money alone cannot be the reason for business to exist". However, profit maximization is extremely relevant when top management is mandated with the job of selecting the right strategy for the business. According to Jackson Mullane, the primary goal for any business strategy exercise must be that of maximizing profitability.

Peter Drucker defined the very purpose of business as creating a satisfied customer. This definition is also useful in evaluating to what extent a business is succeeding in fulfilling its stated purpose.

Many observers would hold that concepts such as economic value added (EVA) are useful in balancing profit-making objectives with other ends. They argue that sustainable financial returns are not possible without taking into account the aspirations and interests of other stakeholders (customers, employees, society, environment). This conception suggests that a principal challenge for a business is to balance the interests of parties affected by the business, interests that are sometimes in conflict with one another. However, former President Bill Clinton stated adamantly that major multinational companies must put their customers and employees' interests before those of shareholders in order to promote economic development and growth, especially in emerging markets. For example, Alibaba, a Chinese Internet venture, strives to operate in the zone that Clinton calls "double-bottom line capitalism." The emerging new mantra is to cause social progress as well as create profits.

Rohit Kishore persuades that business can also be viewed to exist for the purpose of creative expansion. This is true from the perspective of multiple stakeholders. Successful firms like Googlemanage to align their activities towards the purpose of creative expansion from the perspective of all stakeholders, especially employees. This also validates the growing importance of innovation (aka creativity) as a core principle for business survival and success.

Spiritual capital theory is a new emerging approach to business purpose, and becomes more and more influential due to the recent financial crisis.

Contract theory

Advocates of business contract theory believe that a business is a community of participants organized around a common purpose. These participants have legitimate interests in how the business is conducted and, therefore, they have legitimate rights over its affairs. Most contract theorists see the enterprise being run by employees and managers as a kind of representative democracy.

Stakeholder theory

Stakeholder theorists believe that people who have legitimate interests in a business also ought to have voice in how. The obvious non-owner, stakeholders are the employees. However, stakeholder theorists take contract theory a step further, maintaining that people outside of the business enterprise ought to have a say in how the business operates. Thus, for example, consumers, even community members who could be affected by what the business does, for example, by the pollutants of a factory, ought to have some control over the business.

Business as property

Some philosophers believe that a business is essentially someone's property, and, as such, that its owners have the right to dispose of it as they see fit, within the confines of the law and morality. They do not believe that workers or consumers have special rights over the property, other than the right not to be harmed by its use without their consent. In this conception, workers voluntarily exchange their labor for wages from the business owner; they have no more right to tell the owner how he will dispose of his property than the owner has to tell them how to spend their wages, which is property belonging to the workers. Similarly, assuming the business has purveyed its goods honestly and with full disclosure, consumers have no inherent rights to govern the business, which belongs to someone else.

Philosophers who subscribe to this view generally point out that a property owner's rights are nevertheless not unlimited, and that they are constrained by morality. Thus, a home owner cannot burn down his home and thereby jeopardize the entire neighborhood. Similarly, a business does not have an unlimited right to pollute the air in the manufacturing process.

Followers of John Locke would suggest that the first instance of property is the property that one has in himself, and that one's labor is an extension of this. The labor theory of value suggests that when one mixes his labor with an object, he thereby makes it his property, and that his labor is the principal means of measuring value. Many classical economists and Marxists both subscribe to this view. Marxists also believe that modern production, which involves many inputs, makes an equitable division of this property impossible, which, among other reasons, necessitates that the state hold property and the factors of production in common for everyone. They assert that labor value provides an objective measure of economic activity, compared to price and other measures which they see as subjective and fluctuating.

Many neo-classical thinkers, for example, Ludwig von Mises, believe that value is subjective and that labor is incommensurable (e.g., comparing the labor of a house painter to the labor ofPicasso). They return to the classical belief in practice but assert that price is objective, the product of multiple, albeit subjective, valuations. Moreover, they assert that what really matters for assigning ownership is whether or not property was acquired or exchanged legally (see Robert Nozick), which is known as the historical entitlement theory, whereas Marxists assert that there are no property rights in the means of production.

Libertarian socialists, sometimes known as left-anarchists, hold that, as Proudhon said, "Property is theft" — that is, in reference to the ownership of productive resources, property is not the right to use, but the right to keep others from using. Advocates of this philosophy therefore hold the "institution of property", as they sometimes call it, to be immoral in itself, so the accumulation of wealth that includes productive resources, especially land, is also immoral. This means that no business can really be ethical, since the very foundation of business as we know it is private property.

A mini-republic or modern village

Some philosophers see the business enterprise as a means of transmitting social justice, as a kind of mini-republic. This is especially true of contract and stakeholder theorists. Those who view a business as being primarily someone's property reject this view. While they might believe that the net effect of people disposing and exchanging their property freely will benefit society as a whole, they would argue, even if this were not the case, if there were no utilitarian advantage, one ought not to limit another's freedom, that is, unless it is harmful to others.

Regardless of how one thinks about these matters, it is undeniable that a business enterprise represents an increasingly important part of people's lives, especially the employees working there, for, in many ways, the business constitutes a person's principal social group, and it amounts to a replacement for the village or tribe that was the central social setting for our ancestors. In many ways, one's affiliation with a business is the most important social institution most of us have outside of the family.

The ontology of the business enterprise

What makes a business a business? We take for granted that a business is a profit-making entity. How, then, are we to characterize a business that is run only for the benefit of the people who buy from it, for example, a so-called co-operative? Similarly, how might we characterize an insurance business that is owned by its clients, as in the case of a mutual insurance company? Do the owners of insurance policies buy them primarily for a profit? What about charitable enterprises, such as Goodwill Industries, or religious organizations such as Trinity Broadcasting Network? Are all of these organizations businesses in the same sense as, say, General Motors is?

What is it that fundamentally distinguishes a business from other kinds of organizations, say, governmental organizations? For example, how could we characterize quasi-governmental organizations such as the U.S. Post Office and Amtrak, which are supposed to be self-sustaining, even profitable (for reinvestment, reducing or eliminating taxpayer subsidy, reserves)? Would we call such organizations businesses? One might suggest that these are run for the benefit of society, whereas a business is to satisfy the interests of its owners. However, is it not the case that society owns the government? One also would have to ask, how is one entity's satisfying the various interests of some segment of society substantially different from another entity's making a profit that also satisfies various interests, sometimes even the same ones?

What about a person who trades his labor in return for a wage? Is he also in business? After all, he is putting up risk capital, in the sense that he's giving up his time...an opportunity cost...and even making an investment of himself, his labor. He is performing a service, just as a business does. His employer is, in a sense, a customer, someone whom he must satisfy. And the employee markets himself, his skills, either to get a job or to get ahead. He has either an explicit or implicit performance agreement, a contract. He even hopes that his revenues will exceed his expenses, which is to say, that his efforts will be profitable. Does this, therefore, make every laborer a business person?

In other words, a philosopher might reasonably ask, what elements constitute the essential and distinguishing characteristics of a business enterprise? Perhaps it ends up being something as simple as being one or more persons engaged in any number of possible exchanges that satisfies any number of possible interests in an intentional, organized, planned manner. In any case, these are at least some of the questions one might ask about the ontology of a business.

The epistemology and logic of business

In the epistemology of business, we ask what are business facts and how do we come to know them? What constitutes business knowledge versus mere belief? As in other aspects of life, in business we acquire our knowledge through empirical study, from which we draw conclusions using inductive or deductive methods. We test our hypotheses, using them as long as they are not empirically falsified, and thereby develop business theories, organized explanations of the facts. To what extent is what we purport to be business knowledge...other than that which is relatively trivial...reliable or veridical?

Business relies heavily on inductive reasoning, which assumes a uniformity of nature, such that the future is assumed to resemble the past. This, of course, is problematic, especially when considering the complexity involved in adequately factoring in the effects of customers, competitors, legislative and regulatory encumbrances, employees, environmental and climatic hazards, war, new technology, and so forth, into useful quantitative formulae. It is impossible to bind all of the variables for making probabilistic judgments on many of the most important business problems with a high degree of confidence. For this reason (among others)...because of the number of variables and the sheer unpredictability of outcomes...there is a rather considerable risk of failure in business; conversely, there would seem to be a rather high degree of luck in achieving success, or putting it in the vernacular, being at the right place at the right time. This relates to the simple fact that business knowledge is highly tentative, and subject to error or obsolescence.

The philosopher of business might also reasonably ask, to what extent does intuition play a role in our business knowledge. What does it mean to have "a gut feeling" about a business matter, and how is it useful. Is there even such a thing as business intuition, or is it simply a matter of internalizing knowledge through a variety of experiences, such that it seems intuitive. At the very least, a great many managers and marketers would say that they operate using their intuition a great deal, perhaps especially in dealing with people, which, of course, leads us to inquire into the role of psychology.

Chapter 5

Board of directors

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company ororganization. Other names include board of governors, board of managers, board of regents, board of trustees, and board of visitors. It is often simply referred to as "the board".

A board's activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority outside itself. These matters are typically detailed in the organization's bylaws. The bylaws commonly also specify the number of members of the board, how they are to be chosen, and when they are to meet.

In an organization with voting members, e.g., a professional society, the board acts on behalf of, and is subordinate to, the organization's full group, which usually chooses the members of the board. In a stock corporation, the board is elected by the shareholders and is the highest authority in the management of the corporation. In a non-stock corporation with no general voting membership, e.g., a typical university, the board is the supreme governing body of the institution; its members are sometimes chosen by the board itself.

Typical duties of boards of directors include:

- governing the organization by establishing broad policies and objectives;
- selecting, appointing, supporting and reviewing the performance of the chief executive;
- ensuring the availability of adequate financial resources;
- approving annual budgets;
- accounting to the stakeholders for the organization's performance;
- setting the salaries and compensation of company management;

The legal responsibilities of boards and board members vary with the nature of the organization, and with the jurisdiction within which it operates. For companies with publicly trading stock, these responsibilities are typically much more rigorous and complex than for those of other types.

Typically the board chooses one of its members to be the chairman, who holds whatever title is specified in the bylaws.

Directors

The directors of an organization are the persons who are members of its board. Several specific terms categorize directors by the presence or absence of their other relationships to the organization.

An inside director is a director who is also an employee, officer, major shareholder, or someone similarly connected to the organization. Inside directors represent the interests of the entity'sstakeholders, and often have special knowledge of its inner workings, its financial or market position, and so on.

Typical inside directors are:

- A Chief Executive Officer (CEO) who may also be Chairman of the Board
- Other executives of the organization, such as its Chief Financial Officer (CFO) or Executive Vice President
- Large shareholders (who may or may not also be employees or officers)
- Representatives of other stakeholders such as labor unions, major lenders, or members of the community in which the organization is located

An inside director who is employed as a manager or executive of the organization is sometimes referred to as an executive director (not to be confused with the title executive directorsometimes used for the CEO position). Executive directors often have a specified area of responsibility in the organization, such as finance, marketing, human resources, or production.[8]

An outside director is a member of the board who is not otherwise employed by or engaged with the organization, and does not represent any of its stakeholders. A typical example is a director who is president of a firm in a different industry.[9]

Outside directors bring outside experience and perspective to the board. They keep a watchful eye on the inside directors and on the way the organization is run. Outside directors are often useful in handling disputes between inside directors, or between shareholders and the board. They are thought to be advantageous because they can be objective and present little risk of conflict of interest. On the other hand, they might lack familiarity with the specific issues connected to the organization's governance.

Terminology

- Director - a person appointed to serve on the board of an organization, such as an institution or business.
- Inside director - a director who, in addition to serving on the board, has a meaningful connection to the organization
- Outside director - a director who, other than serving on the board, has no meaningful connections to the organization
- Executive director - an inside director who is also an executive with the organization. The term is also used, in a completely different sense, to refer to a CEO
- Non-executive director - a director who is not an executive with the organization
- Shadow director - an individual who is not a named director but who nevertheless directs or controls the organization

Individual directors often serve on more than one board. This practice results in an interlocking directorate, where a relatively small number of individuals have significant influence over a large number of important entities. This situation can have important corporate, social, economic, and legal consequences, and has been the subject of significant research.

Process

The process for running a board, sometimes called the board process, includes the selection of board members, the setting of clear board objectives, the dissemination of documents or board package to the board members, the collaborative creation of an agenda for the meeting, the creation and follow-up of assigned action items, and the assessment of the board process through standardized assessments of board members, owners, and CEOs. The science of this process has been slow to develop due to the secretive nature of the way most companies run their boards, however some standardization is beginning to develop. Some who are pushing for this standardization in the USA are the National Association of Corporate Directors, McKinseyConsulting and The Board Group.

Non-corporate boards

The role and responsibilities of a board of directors vary depending on the nature and type of business entity and the laws applying to the entity (see types of business entity). For example, the nature of the business entity may be one that is traded on a public market (public company), not traded on a public market (a private, limited or closely held company), owned by family members (a family business), or exempt from income taxes (a non-profit, not for profit, or tax-exempt entity). There are numerous types of business entities available throughout the world such as a corporation, limited liability company, cooperative, business trust, partnership, private limited company, and public limited company.

Much of what has been written about boards of directors relates to boards of directors of business entities actively traded on public markets.   More recently, however, material is becoming available for boards of private and closely held businesses including family businesses.

A board-only organization is one whose board is self-appointed, rather than being accountable to a base of members through elections; or in which the powers of the membership are extremely limited.

Corporations

In a publicly held company, directors are elected to represent and are legally obligated to represent the interests of the owners of the company—the shareholders/stockholders. In this capacity they establish policies and make decisions on issues such as whether there is dividend and how much it is, stock options distributed to employees, and the hiring/firing and compensation of upper management.

Governance

Theoretically, the control of a company is divided between two bodies: the board of directors, and the shareholders in general meeting. In practice, the amount of power exercised by the board varies with the type of company. In small private companies, the directors and the shareholders are normally the same people, and thus there is no real division of power. In large public companies, the board tends to exercise more of a supervisory role, and individual responsibility and management tends to be delegated downward to individual professional executives (such as a finance director or a marketing director) who deal with particular areas of the company's affairs.

Another feature of boards of directors in large public companies is that the board tends to have more de facto power. Many shareholders grant proxies to the directors to vote their shares at general meetings and accept all recommendations of the board rather than try to get involved in management, since each shareholder's power, as well as interest and information is so small. Larger institutional investors also grant the board proxies. The large number of shareholders also makes it hard for them to organize. However, there have been moves recently to try to increaseshareholder activism among both institutional investors and individuals with small shareholdings.

A contrasting view is that in large public companies it is upper management and not boards that wield practical power, because boards delegate nearly all of their power to the top executive employees, adopting their recommendations almost without fail. As a practical matter, executives even choose the directors, with shareholders normally following management recommendations and voting for them.

In most cases, serving on a board is not a career unto itself, but board members often receive remunerations amounting to hundreds of thousands of dollars per year since they often sit on the boards of several companies. Inside directors are usually not paid for sitting on a board, but the duty is instead considered part of their larger job description. Outside directors are usually paid for their services. These remunerations vary between corporations, but usually consist of a yearly or monthly salary, additional compensation for each meeting attended, stock options, and various other benefits. Tiffany & Co., for example, pays directors an annual retainer of $46,500, an additional annual retainer of $2,500 if the director is also a chairperson of a committee, a per-meeting-attended fee of $2,000 for meetings attended in person, a $500 fee for each meeting attended via telephone, in addition to stock options and retirement benefits.

Two-tier system

In some European Union and Asian countries, there are two separate boards, an executive board for day-to-day business and a supervisory board (elected by the shareholders and employees) for supervising the executive board. In these countries, the CEO (chief executive or managing director) presides over the executive board and the chairman presides over the supervisory board, and these two roles will always be held by different people. This ensures a distinction between management by the executive board and governance by the supervisory board and allows for clear lines of authority. The aim is to prevent a conflict of interest and too much power being concentrated in the hands of one person. There is a strong parallel here with the structure of government, which tends to separate the political cabinet from the management civil service. In the United States, the board of directors (elected by the shareholders) is often equivalent to the supervisory board, while the executive board may often be known as the executive committee (operating committee or executive council), composed of the CEO and their direct reports (other C-level officers, division/subsidiary heads).

History

The development of a separate board of directors to manage the company has occurred incrementally and indefinitely over legal history. Until the end of the 19th century, it seems to have been generally assumed that the general meeting (of all shareholders) was the supreme organ of the company, and the board of directors was merely an agent of the company subject to the control of the shareholders in general meeting.

However, by 1906, the English Court of Appeal had made it clear in the decision of Automatic Self-Cleansing Filter Syndicate Co v Cunningham [1906] 2 Ch 34 that the division of powers between the board and the shareholders in general meaning depended on the construction of the articles of association and that, where the powers of management were vested in the board, the general meeting could not interfere with their lawful exercise. The articles were held to constitute a contract by which the members had agreed that "the directors and the directors alone shall manage."

The new approach did not secure immediate approval, but it was endorsed by the House of Lords in Quin & Axtens v Salmon [1909] AC 442 and has since received general acceptance. Under English law, successive versions of Table A have reinforced the norm that, unless the directors are acting contrary to the law or the provisions of the Articles, the powers of conducting the management and affairs of the company are vested in them.

The modern doctrine was expressed in Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113 by Greer LJ as follows:

"A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of shareholders can control the exercise of powers by the articles in the directors is by altering the articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders."

It has been remarked that this development in the law was somewhat surprising at the time, as the relevant provisions in Table A (as it was then) seemed to contradict this approach rather than to endorse it.

Election and removal

In most legal systems, the appointment and removal of directors is voted upon by the shareholders in general meeting or through a proxy statement. For publicly traded companies in the U.S., the directors which are available to vote on are largely selected by either the board as a whole or a nominating committee. Although in 2002 the NYSE and the NASDAQ required that nominating committees consist of independent directors as a condition of listing, nomination committees have historically received input from management in their selections even when the

CEO does not have a position on the board. Shareholder nominations can only occur at the general meeting itself or through the prohibitively expensive process of mailing out ballots separately; in May 2009 the SEC proposed a new rule allowing shareholders meeting certain criteria to add nominees to the proxy statement. In practice for publicly traded companies, the managers (inside directors) who are purportedly accountable to the board of directors have historically played a major role in selecting and nominating the directors who are voted on by the shareholders, in which case more "gray outsider directors" (independent directors with conflicts of interest) are nominated and elected.

Directors may also leave office by resignation or death. In some legal systems, directors may also be removed by a resolution of the remaining directors (in some countries they may only do so "with cause"; in others the power is unrestricted).

Some jurisdictions also permit the board of directors to appoint directors, either to fill a vacancy which arises on resignation or death or as an addition to the existing directors.

In practice, it can be quite difficult to remove a director by a resolution in general meeting. In many legal systems, the director has a right to receive special notice of any resolution to remove him or her; the company must often supply a copy of the proposal to the director, who is usually entitled to be heard by the meeting. The director may require the company to circulate any representations that he wishes to make. Furthermore, the director's contract of service will usually entitle him to compensation if he is removed, and may often include a generous "golden parachute" which also acts as a deterrent to removal

In a recent academic study that was published in the Journal of Applied Finance, Drexel University’s LeBow College of Business professors Jie Cai, Jacqueline Garner, and Ralph Walkling examined how corporate shareholders voted in nearly 2,500 director elections in the United States. They found that directors received fewer votes from shareholders when their companies performed poorly, had excess CEO compensation, or had poor shareholder protection. They also found that directors received fewer votes when they did not regularly attend board meetings or received negative recommendations from Risk Metrics (a proxy advisory firm). This evidence suggests that some shareholders express their displeasure with a company by voting against its directors. The article also shows that companies often improve their corporate governance by removing poison pills or classified boards and by reducing excessive CEO pay after their directors receive low shareholder support.

Board accountability to shareholders is a recurring issue. In 2010, the New York Times noted that several directors who had overseen companies which had failed in the financial crisis of 2007–2010 had found new positions as directors. The SEC sometimes imposes a ban (a "D&O bar") on serving on a board as part of its fraud cases, and one of these was upheld in 2013.

Exercise of powers

The exercise by the board of directors of its powers usually occurs in board meetings. Most legal systems require sufficient notice to be given to all directors of these meetings, and that a quorummust be present before any business may be conducted. Usually, a meeting which is held without notice having been given is still valid if all of the directors attend, but it has been held that a failure to give notice may negate resolutions passed at a meeting, because the persuasive oratory of a minority of directors might have persuaded the majority to change their minds and vote otherwise.

In most common law countries, the powers of the board are vested in the board as a whole, and not in the individual directors. However, in instances an individual director may still bind the company by his acts by virtue of his ostensible authority (see also: the rule in Turquand's Case).

Duties

Because directors exercise control and management over the organization, but organizations are (in theory) run for the benefit of the shareholders, the law imposes strict duties on directors in relation to the exercise of their duties. The duties imposed on directors are fiduciary duties, similar to those that the law imposes on those in similar positions of trust: agents and trustees.

The duties apply to each director separately, while the powers apply to the board jointly. Also, the duties are owed to the company itself, and not to any other entity.This does not mean that directors can never stand in a fiduciary relationship to the individual shareholders; they may well have such a duty in certain circumstances.

"Proper purpose"

Directors must exercise their powers for a proper purpose. While in many instances an improper purpose is readily evident, such as a director looking to feather his or her own nest or divert an investment opportunity to a relative, such breaches usually involve a breach of the director's duty to act in good faith. Greater difficulties arise where the director, while acting in good faith, is serving a purpose that is not regarded by the law as proper.

The seminal authority in relation to what amounts to a proper purpose is the Privy Council decision of Howard Smith Ltd v Ampol Ltd (1974) AC 821. The case concerned the power of the directors to issue new shares. It was alleged that the directors had issued a large number of new shares purely to deprive a particular shareholder of his voting majority. An argument that the power to issue shares could only be properly exercised to raise new capital was rejected as too narrow, and it was held that it would be a proper exercise of the director's powers to issue shares to a larger company to ensure the financial stability of the company, or as part of an agreement to exploit mineral rights owned by the company. If so, the mere fact that an incidental result (even if it was a desired consequence) was that a shareholder lost his majority, or a takeover bid was defeated, this would not itself make the share issue improper. But if the sole purpose was to destroy a voting majority, or block a takeover bid, that would be an improper purpose.

Not all jurisdictions recognised the "proper purpose" duty as separate from the "good faith" duty however.

"Unfettered discretion"

Directors cannot, without the consent of the company, fetter their discretion in relation to the exercise of their powers, and cannot bind themselves to vote in a particular way at future board meetings. This is so even if there is no improper motive or purpose, and no personal advantage to the director.

This does not mean, however, that the board cannot agree to the company entering into a contract which binds the company to a certain course, even if certain actions in that course will require further board approval. The company remains bound, but the directors retain the discretion to vote against taking the future actions (although that may involve a breach by the company of thecontract that the board previously approved).

"**Conflict of duty and interest"**

As fiduciaries, the directors may not put themselves in a position where their interests and duties conflict with the duties that they owe to the company. The law takes the view that good faith must not only be done, but must be manifestly seen to be done, and zealously patrols the conduct of directors in this regard; and will not allow directors to escape liability by asserting that his decision was in fact well founded. Traditionally, the law has divided conflicts of duty and interest into three sub-categories.

Chapter 6

Corporate Social Responsibly

Corporate social responsibility (CSR, also called corporate conscience, corporate citizenship, social performance, or sustainable responsible business/ Responsible Business) is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms. In some models, a firm's implementation of CSR goes beyond compliance and engages in "actions that appear to further some social good, beyond the interests of the firm and that which is required by law."CSR is a process with the aim to embrace responsibility for the company's actions and encourage a positive impact through its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere who may also be considered as stakeholders.

The term "corporate social responsibility" became popular in the 1960s and has remained a term used indiscriminately by many to cover legal and moral responsibility more narrowly construed.

Proponents argue that corporations make more long term profits by operating with a perspective, while critics argue that CSR distracts from the economic role of businesses. McWilliams and Siegel's article (2000) published in Strategic Management Journal, cited by over 1000 academics, compared existing econometric studies of the relationship between social and financial performance. They concluded that the contradictory results of previous studies reporting positive, negative, and neutral financial impact, were due to flawed empirical analysis. McWilliams and Siegel demonstrated that when the model is properly specified; that is, when you control for investment in Research and Development, an important determinant of financial performance, CSR has a neutral impact on financial outcomes.

In his widely cited book entitled Misguided Virtue: False Notions of Corporate Social Responsibility (2001) David Henderson argued forcefully against the way in which CSR broke from traditional corporate value-setting. He questioned the "lofty" and sometimes "unrealistic expectations" in CSR.

Some argue that CSR is merely window-dressing, or an attempt to pre-empt the role of governments as a watchdog over powerful multinational corporations. Political sociologists became interested in CSR in the context of theories of globalization, neo-liberalism, and late capitalism. Adopting a critical approach, sociologists emphasize CSR as a form of capitalist legitimacy and in particular point out that what has begun as a social movement against uninhibited corporate power has been co-opted by and transformed by corporations into a 'business model' and a 'risk management' device, often with questionable results

CSR is titled to aid an organization's mission as well as a guide to what the company stands for and will uphold to its consumers. Development business ethics is one of the forms of applied ethics that examines ethical principles and moral or ethical problems that can arise in a business environment. ISO 26000 is the recognized international standard for CSR. Public sector organizations (the United Nations for example) adhere to the triple bottom line (TBL). It is widely accepted that CSR adheres to similar principles but with no formal act of legislation. The UN has developed the Principles for Responsible Investment as guidelines for investing entities.

CSR Approaches

Some commentators have identified a difference between the Canadian (Montreal school of CSR), the Continental European and the Anglo-Saxon approaches to CSR. And even within Europe the discussion about CSR is very heterogeneous.

A more common approach to CSR is corporate philanthropy. This includes monetary donations and aid given to local and non-local nonprofit organizations and communities, including donations in areas such as the arts, education, housing, health, social welfare, and the environment, among others, but excluding political contributions and commercial sponsorship of events. Some organizations[who?] do not like a philanthropy-based approach as it might not help build on the skills of local populations, whereas community-based development generally leads to more sustainable development.[clarification needed Difference between local org& community-dev?

Another approach to CSR is to incorporate the CSR strategy directly into the business strategy of an organization. For instance, procurement of Fair Trade tea and coffee has been adopted by various businesses including KPMG. Its CSR manager commented, "Fairtrade fits very strongly into our commitment to our communities."

Another approach is garnering increasing corporate responsibility interest. This is called Creating Shared Value, or CSV. The shared value model is based on the idea that corporate success and social welfare are interdependent. A business needs a healthy, educated workforce, sustainable resources and adept government to compete effectively. For society to thrive, profitable and competitive businesses must be developed and supported to create income, wealth, tax revenues, and opportunities for philanthropy. CSV received global attention in the Harvard Business Review article Strategy & Society: The Link between Competitive Advantage and Corporate Social Responsibility by Michael E. Porter, a leading authority on competitive strategy and head of the Institute for Strategy and Competitiveness at Harvard Business School; and Mark R. Kramer, Senior Fellow at the Kennedy School at Harvard University and co-founder of FSG Social Impact Advisors. The article provides insights and relevant examples of companies that have developed deep linkages between their business strategies and corporate social responsibility. Many approaches to CSR pit businesses against society, emphasizing the costs and limitations of compliance with externally imposed social and environmental standards. CSV acknowledges trade-offs between short-term profitability and social or environmental goals, but focuses more on the opportunities for competitive advantage from building a social value proposition into corporate strategy. CSV has a limitation in that it gives the impression that only two stakeholders are important - shareholders and consumers — and belies the multi-stakeholder approach of most CSR advocates.

Many companies use the strategy of benchmarking to compete within their respective industries in CSR policy, implementation, and effectiveness. Benchmarking involves reviewing competitor CSR initiatives, as well as measuring and evaluating the impact that those policies have on society and the environment, and how customers perceive competitor CSR strategy. After a comprehensive study of competitor strategy and an internal policy review performed, a comparison can be drawn and a strategy developed for competition with CSR initiatives.

Cost-benefit analysis with a resource-based view

In competitive markets the cost-benefit analysis regarding positive financial outcomes upon implementing a CSR-based strategy, can be examined with a lens of the resource-based-view (RBV) of sustainable competitive advantage. According to Barney's (1990) "formulation of the RBV, sustainable competitive advantage requires that resources be valuable (V), rare (R), inimitable (I) and non-substitutable (S)." A firm can conduct a cost benefit analysis through a RBV-based lens to determine the optimal and appropriate level of investment in CSR, as it would with any other investments. A firm introducing a CSR-based strategy might only sustain high returns on their investment if their CSR-based strategy were inimitable (I) by their competitors. In competitive markets, a firm introducing a CSR-based strategy might only sustain high returns on their investment and there may only be a short-lived strategic competitive advantage to implementing CSR as their competitors may adopt similar strategies. There is however, a long-term advantage in that competitors may also imitate CSR-based strategies in a socially responsible way. Even if a firm chooses CSR for strategic financial gain, the firm is also acting responsibly. Attention to CSR as an element in corporate strategy led to examining CSR activities through the lens of the resource-based-view (RBV) of the firm. The RBV, as introduced by Wernerfelt (1984) and refined by Barney (1991), presumes that firms are bundles of heterogeneous resources and capabilities that are imperfectly mobile across firms. Accordingly, the imperfect mobility of heterogeneous resources can result in competitive advantages for firms that have superior resources or capabilities. McWilliams and Siegel (2001) used a model based on RBV to address optimal investment in CSR. In their model, CSR activities and attributes may be used in a differentiation strategy. They conclude that managers can determine the appropriate level of investment in CSR by conducting cost benefit analysis in the same way that they analyze other investments. Applying the RBV to CSR naturally leads to the question of whether firms can use CSR to achieve a sustainable competitive advantage. Reinhardt (1998) addressed this issue and found that a firm engaging in a CSR-based strategy could only sustain an abnormal return if it could prevent competitors from imitating its strategy.

Incidents like the 2013 Savar building collapse with more than 1,100 victims have led to a shift from company-individual thinking towards supply-chain thinking in order to increase social responsibility. Thus, best practices from supply chain management are increasingly applied to the CSR context. Wieland and Handfield (2013) suggest that companies need to audit products and suppliers and that supplier auditing needs to go beyond direct relationships with first-tier suppliers. They also demonstrate that visibility needs to be improved if supply cannot be directly controlled and that smart and electronic technologies play a key role to improve visibility across the supply chain. Finally, they highlight that collaboration with local partners, across the industry and with universities is crucial to successfully managing social responsibility in supply chains.

Social accounting, auditing, and reporting

For a business to take responsibility for its actions, that business must be fully accountable. Social accounting, a concept describing the communication of social and environmental effects of a company's economic actions to particular interest groups within society and to society at large, is thus an important element of CSR.

Social accounting emphasizes the notion of corporate accountability. D. Crowther defines social accounting in this sense as "an approach to reporting a firm’s activities which stresses the need for the identification of socially relevant behavior, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques." An example of social accounting, to a limited extent, is found in an annual Director's Report, under the requirements of UK company law.

A number of reporting guidelines or standards have been developed to serve as frameworks for social accounting, auditing and reporting including:

- AccountAbility's AA1000 standard, based on John Elkington's triple bottom line (3BL) reporting
- The Prince's Accounting for Sustainability Project's Connected Reporting Framework[dead link]
- The Fair Labor Association conducts audits based on its Workplace Code of Conduct and posts audit results on the FLA website.
- The Fair Wear Foundation takes a unique approach to verifying labour conditions in companies' supply chains, using interdisciplinary auditing teams.

- Global Reporting Initiative's Sustainability Reporting Guidelines
- Economy for the Common Good's Common Good Balance Sheet
- GoodCorporation's Standard developed in association with the Institute of Business Ethics
- Synergy Codethic 26000 Social Responsibility and Sustainability Commitment Management System (SRSCMS) Requirements — Ethical Business Best Practices of Organizations - the necessary management system elements to obtain a certifiable ethical commitment management system. The standard scheme has been build around ISO 26000 and UNCTAD Guidance on Good Practices in Corporate Governance.The standard is applicable by any type of organization.;

- Earthcheck www.earthcheck.org Certification / Standard
- Social Accountability International's SA8000 standard
- Standard Ethics Aei guidelines
- The ISO 14000 environmental management standard
- The United Nations Global Compact requires companies to communicate on their progress (or to produce a Communication on Progress, COP), and to describe the company's implementation of the Compact's ten universal principles. This information should be fully integrated in the participant’s main medium of stakeholder communications, for example a corporate responsibility or sustainability report and/or an integrated financial and sustainability report. If a company does not publish formal reports, a COP can be created as a stand-alone document.
- The United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) provides voluntary technical guidance on eco-efficiency indicators, corporate responsibility reporting, and corporate governance disclosure.

The FTSE Group publishes the FTSE4Good Index, an evaluation of CSR performance of companies.

In some nations, legal requirements for social accounting, auditing and reporting exist (e.g. in the French bilan social), though international or national agreement on meaningful measurements of social and environmental performance is difficult. Many companies now produce externally audited annual reports that cover Sustainable Development and CSR issues ("Triple Bottom Line Reports"), but the reports vary widely in format, style, and evaluation methodology (even within the same industry). Critics dismiss these reports as lip service, citing examples such as Enron's yearly "Corporate Responsibility Annual Report" and tobacco corporations' social reports.

In South Africa, as of June 2010, all companies listed on the Johannesburg Stock Exchange (JSE) were required to produce an integrated report in place of an annual financial report and sustainability report. An integrated report includes environmental, social and economic performance alongside financial performance information and is expected to provide users with a more holistic overview of a company. However, this requirement was implemented in the absence of any formal or legal standards for an integrated report. An Integrated Reporting Committee (IRC) was established to issue guidelines for good practice in this field.

Social license

“Social license” generally refers to a local community’s acceptance or approval of a company’s project or ongoing presence in an area. It is increasingly recognized by various stakeholders and communities as a prerequisite to development. The development of social license occurs outside of formal permitting or regulatory processes, and requires sustained investment by proponents to acquire and maintain social capital within the context of trust-based relationships. Often intangible and informal, social license can nevertheless be realized through a robust suite of actions centered on timely and effective communication, meaningful dialogue, and ethical and responsible behavior.

Local conditions, needs, and customs vary considerably and are often opaque, but have a significant impact on the likely success of various approaches to building social capital and trust. These regional and cultural differences demand a flexible and responsive approach and must be understood early in order to enable the development and implementation of an effective strategy to earn and maintain social license. Governments could facilitate the necessary stakeholder mapping in regions for which they are responsible and provide a regulatory framework that sets companies on the right path for engagement with communities and stakeholders. Social media tools empower stakeholders and communities to access and share information on company behaviors, technologies, and projects as they are implemented around the world. Understanding and managing this reality will be important for companies seeking social license. Voluntary measures integral to corporate-responsibility frameworks contribute to achieving social license, particularly through enhancing a company’s reputation and strengthening its capacity for effective communication, engagement, and collaboration. However, such measures do not obviate the need for project-specific action to earn and maintain social license. The growing reliance on social media tools by stakeholders and proponents alike, and the risks associated with disclosure through them, may lead to an increase.More in Pacific Energy Summit.

Potential business benefits

The scale and nature of the benefits of CSR for an organization can vary depending on the nature of the enterprise, and are difficult to quantify, though there is a large body of literature exhorting business to adopt measures beyond financial ones (e.g., Deming's Fourteen Points, balanced scorecards). Orlitzky, Schmidt, and Rynes found a correlation between social/environmental performance and financial performance. However, businesses may not be looking at short-run financial returns when developing their CSR strategy. Intel employs a 5-year CSR planning cycle.

The definition of CSR used within an organization can vary from the strict "stakeholder impacts" definition used by many CSR advocates and will often include charitable efforts and volunteering. CSR may be based within the human resources, business development or public relations departments of an organisation, or may be given a separate unit reporting to the CEO or in some cases directly to the board. Some companies may implement CSR-type values without a clearly defined team or programme.

The business case for CSR within a company will likely rest on one or more of these arguments:

Triple bottom line

People planet profit, also known as the triple bottom line, are words that should be used and practiced in every move an organization makes. People relates to fair and beneficial business practices toward labour, the community and region where corporation conducts its business. Planet refers to sustainable environmental practices. A triple bottom line company does not produce harmful or destructive products such as weapons, toxic chemicals or batteries containing dangerous heavy metals for example. Profit is the economic value created by the organization after deducting the cost of all inputs, including the cost of the capital tied up. It therefore differs from traditional accounting definitions of profit.

Despite the fact that adopting this triple measure has helped some companies be more conscious of their social and moral responsibilities, the triple bottom line has its critics. The first criticism is that the reporting of environmental and social/moral responsibilities is selective and ignores some real moral demands, thus substituting the adopted list for a company or its members paying attention to its myriad moral obligations. The second criticism is that there is no guaranteed-upon way to carry out the environmental and social/moral audits comparable to the way that companies carry out their financial audits-much of which is governed by government requirements. An inherent difficulty with any social reporting is that it is not quantifiable in the way that a financial report is. There is no quantitative method that captures what is significantly at issue and no agreed-upon way to represent qualitative measures.

Human resources

A CSR program can be an aid to recruitment and retention, particularly within the competitive graduate student market. Potential recruits often ask about a firm's CSR policy during an interview, and having a comprehensive policy can give an advantage. CSR can also help improve the perception of a company among its staff, particularly when staff can become involved throughpayroll giving, fundraising activities or community volunteering. CSR has been found to encourage customer orientation among frontline employees.

Risk management

Managing risk is a central part of many corporate strategies. Reputations that take decades to build up can be ruined in hours through incidents such as corruption scandals or environmental accidents. These can also draw unwanted attention from regulators, courts, governments and media. Building a genuine culture of 'doing the right thing' within a corporation can offset these risks.

Brand differentiation

In crowded marketplaces, companies strive for a unique selling proposition that can separate them from the competition in the minds of consumers. CSR can play a role in building customer loyalty based on distinctive ethical values. Several major brands, such as The Co-operative Group, The Body Shop and American Apparel are built on ethical values. Business service organizations can benefit too from building a reputation

An engagement plan will assist in reaching a desired audience. A corporate social responsibility team, or individual is needed to effectively plan the goals and objectives of the organization. Determining a budget should be of high priority. The function of corporate social responsibility planning: 1. To add discussion and analysis of a new set of risks into corporate decision-making. 2. To represent issues within the corporation that watchdogs, NGOs and advocates represent within society. 3. To assess the future. An organizations long term and short term future needs to be thought of. 4. To help prioritize consideration of socially and environmentally friendly projects that might otherwise lack a corporate advocate. 5. To keep corporations aware of potential major societal impacts even when a negative impact may not be immediate, and thus lessen liability. 6. To positively influence decision making where societal impacts are maximized, whilst ensuring efforts are within a given budget.

Developing an engagement plan

Commit to coming up with and improving on your companies goals. CSR commitments communicate the nature and direction of the firm's social and environmental activities and, will help others understand how the organization is likely to behave in a particular situation 1. Do a scan of CSR commitments 2. Hold discussions with major stakeholders 3. Create a working group to develop the commitments 4. Prepare a preliminary draft 5. Consult with affected stakeholders 6. Revise and publish the commitments 7. Consider what is feasible within the budget • To ensure employee buy-in, include employees in the process of developing the vision and values. To spark the process, create a CSR working group or hold a contest for the best suggestions, encouraging employees and their representatives to put some thought into their submissions. • Host a visioning session and ask participants to think about what the firm could look like in the future as a CSR leader. • Review the CSR priorities to determine which codes of ethics or conduct fit best with the firm's goals.

Consultants are recommended when planning for CSR activities involving small, medium and large sized corporations. All levels of management should be on board, and the support of high ranking corporate officials should be given.

License to operate

Corporations are keen to avoid interference in their business through taxation or regulations. By taking substantive voluntary steps, they can persuade governments and the wider public that they are taking issues such as health and safety, diversity, or the environment seriously as good corporate citizens with respect to labour standards and impacts on the environment.

Supplier relations

Businesses are constantly relying on suppliers to reduce overall costs, while improving the quality of their goods or services. Many North American companies have downgraded the volume of suppliers they do business with, and award contracts to a select few, in order to lower operating costs. By establishing a strong supply chain, companies are able to push for continuous quality improvements, and price reductions. The long-term benefits of the listed above create a better value for stakeholders.

Some multi-national companies like General Motors can shift suppliers, if a lower offer is made by the competition. As a result, competitiveness, and greater profits are created, in turn contributing to a stronger market

The strategic use of supplier relations can benefit single, double and triple bottom-lines. Corporations excelling in supply relations include Wal-Mart, Ford, General Motors, Toyota and Nestle. All companies listed above have gained tangeable results through the practice of ensuring sound supply chains, and sourcing materials from ethical sources.

Emphasizing the importance of practicing CSR to suppliers, researching their existing supply chain, and sending out CSR check-sheets to existing suppliers is important to staying on-track of a company’s implemented CSR activity.

Common Types of Corporate Social Responsibility Actions

There are many aspects of corporate social responsibility; whether a company decides to develop one area of CSR, or multiple, the end result is a more profitable company experiencing a higher level of employee engagement. The following is a list of common ways corporate social responsibility is implemented by organizations.

1. Environmental Sustainability: Areas include recycling, waste management, water management, using renewable energy sources, utilizing reusable resources, creating 'greener' supply chains, using digital technology instead of hard copies, developing buildings according to Leadership in Energy and Environmental Design (LEED)® standards, etc. There is a business sector dedicated to specifically to environmental sustainability consulting for businesses of any size to utilize. The highest ranked sustainability consulting firm is Ernst & Young

2. Community Involvement: This can include raising money for local charities, supporting community volunteerism, sponsoring local events, employing people from a community, supporting a community's economic growth, engaging in fair trade practices, etc. Starbucks is an example of a company that focuses on community involvement and engagement; since these programs began the company has seen higher profits and greater employee engagement.

3. Ethical Marketing Practices: Companies that ethically market to consumers are placing a higher value on their customers and respecting them as people who are ends in themselves. They do not try to manipulate or falsely advertise to potential consumers. This is important for companies that want to be viewed as ethical.

Criticisms and concerns

Critics of CSR as well as proponents debate a number of concerns related to it. These include CSR's relationship to the fundamental purpose and nature of business and questionable motives for engaging in CSR, including concerns about insincerity and hypocrisy.

Nature of business

Milton Friedman and others have argued that a corporation's purpose is to maximize returns to its shareholders, and that since only people can have social responsibilities, corporations are only responsible to their shareholders and not to society as a whole. Although they accept that corporations should obey the laws of the countries within which they work, they assert that corporations have no other obligation to society. Some people perceive CSR as incongruent with the very nature and purpose of business, and indeed a hindrance to free trade. Those who assert that CSR is contrasting with capitalism and are in favor of the free market argue that improvements in health, longevity and/or infant mortality have been created by economic growth attributed to free enterprise.

Critics of this argument perceive the free market as opposed to the well-being of society and a hindrance to human freedom. They claim that the type of capitalism practiced in many developing countries is a form of economic and cultural imperialism, noting that these countries usually have fewer labour protections, and thus their citizens are at a higher risk of exploitation by multinational corporations.

A wide variety of individuals and organizations operate in between these poles. For example, the REALeadership Alliance asserts that the business of leadership (be it corporate or otherwise) is to change the world for the better. Many religious and cultural traditions hold that the economy exists to serve human beings, so all economic entities have an obligation to society (see for example Economic Justice for All). Moreover, as discussed above, many CSR proponents point out that CSR can significantly improve long-term corporate profitability because it reduces risks and inefficiencies while offering a host of potential benefits such as enhanced brand reputation and employee engagement.

Some critics believe that CSR programs are undertaken by companies such as British American Tobacco (BAT), the petroleum giant BP (well known for its high-profile advertising campaigns on environmental aspects of its operations), and McDonald's (see below) to distract the public from ethical questions posed by their core operations. They argue that some corporations start CSR programs for the commercial benefit they enjoy through raising their reputation with the public or with government. They suggest that corporations which exist solely to maximize profits are unable to advance the interests of society as a whole.

Another concern is that sometimes companies claim to promote CSR and be committed to sustainable development but simultaneously engage in harmful business practices. For example, since the 1970s, the McDonald's Corporation's association with Ronald McDonald House has been viewed as CSR and relationship marketing. More recently, as CSR has become mainstream, the company has beefed up its CSR programs related to its labor, environmental and other practices All the same, in McDonald's Restaurants v Morris & Steel, Lord Justices Pill, May and Keane ruled that it was fair comment to say that McDonald's employees worldwide 'do badly in terms of pay and conditions' and true that 'if one eats enough McDonald's food, one's diet may well become high in fat etc., with the very real risk of heart disease.'

Royal Dutch Shell has a much-publicized CSR policy and was a pioneer in triple bottom line reporting, but this did not prevent the 2004 scandal concerning its misreporting of oil reserves, which seriously damaged its reputation and led to charges of hypocrisy. Since then, the Shell Foundation has become involved in many projects across the world, including a partnership with Marks and Spencer (UK) in three flower and fruit growing communities across Africa.

Critics concerned with corporate hypocrisy and insincerity generally suggest that better governmental and international regulation and enforcement, rather than voluntary measures, are necessary to ensure that companies behave in a socially responsible manner. A major area of necessary international regulation is the reduction of the capacity of corporations to sue states under investor state dispute settlement provisions in trade or investment treaties if otherwise necessary public health or environment protection legislation has impeded corporate investments. Others, such as Patricia Werhane, argue that CSR should be considered more as a corporate moral responsibility, and limit the reach of CSR by focusing more on direct impacts of the organization as viewed through a systems perspective to identify stakeholders. For a commonly overlooked motive for CSR, see also Corporate Social Entrepreneurship, whereby CSR can also be driven by employees' personal values, in addition to the more obvious economic and governmental drivers.

Principles

The main principles involving corporate social responsibility involve economic, legal, ethical and discretionary aspects. A corporation needs to generate profits, while operating within the laws of the state. The corporation also needs to be ethical, but has the right to be discretional about the decisions it makes. Levels of corporate social responsiveness to an issue include being reactive,defensive, responsive and interactive. All terms are useful in issues management. Selecting when and how to act can make a difference in the outcome of the action taken.

Ethical consumerism

The rise in popularity of ethical consumerism over the last two decades can be linked to the rise of CSR. As global population increases, so does the pressure on limited natural resources required to meet rising consumer demand (Grace and Cohen 2005, 147). Industrialization, in many developing countries, is booming as a result of both technology and globalization. Consumers are becoming more aware of the environmental and social implications of their day-to-day consumer decisions and are therefore beginning to make purchasing decisions related to their environmental and ethical concerns. However, this practice is far from consistent or universal.

Globalization and market forces

As corporations pursue growth through globalization, they have encountered new challenges that impose limits to their growth and potential profits. Government regulations, tariffs, environmental restrictions and varying standards of what constitutes "labor exploitation" are problems that can cost organizations millions of dollars. Some view ethical issues as simply a costly hindrance, while some companies use CSR methodologies as a strategic tactic to gain public support for their presence in global markets, helping them sustain a competitive advantage by using their social contributions to provide a subconscious level of advertising. (Fry, Keim, Meiners 1986, 105) Global competition places a particular pressure on multinational corporations to examine not only their own labor practices, but those of their entire supply chain, from a CSR perspective. that all government is controlling.

Social awareness and education

The role among corporate stakeholders is to work collectively to pressure corporations that are changing. Shareholders and investors themselves, through socially responsible investing are exerting pressure on corporations to behave responsibly. The extension of SRI bodies driving corporations to include an element of ‘ethical investment’ into their corporate agenda’s generates socially embedded issues. The main issue correlates to the development and overall idea of ‘ethical investing’ or SRI, a concept that is constructed as a general social perspective. The problem becomes defining what is classified as ‘ethical investing’. The ethics or values of one SRI body will likely different from the next since ethical opinions are inherently paradoxical. For example, some religious investors in the US have withdrawn investment from companies that fail to fulfill their ethical expectations. The Non-governmental organizations are also taking an increasing role, leveraging the power of the media and the Internet to increase their scrutiny and collective activism around corporate behavior. Through education and dialogue, the development of community awareness in holding businesses responsible for their actions is growing. In recent years[when?], the traditional conception of CSR is being challenged by the more community-conscious Creating Shared Value concept (CSV), and several companies are refining their collaboration with stakeholders accordingly.

Ethics training

The rise of ethics training inside corporations, some of it required by government regulation, is another driver credited with changing the behavior and culture of corporations. The aim of such training is to help employees make ethical decisions when the answers are unclear. Tullberg believes that humans are built with the capacity to cheat and manipulate, a view taken from Trivers (1971, 1985), hence the need for learning normative values and rules in human behavior. The most direct benefit is reducing the likelihood of "dirty hands" (Grace and Cohen 2005), fines and damaged reputations for breaching laws or moral norms. Organizations also see secondary benefit in increasing employee loyalty and pride in the organization. Caterpillar and Best Buy are examples of organizations that have taken such steps.

Increasingly, companies are becoming interested in processes that can add visibility to their CSR policies and activities. One method that is gaining increasing popularity is the use of well-grounded training programs, where CSR is a major issue, and business simulations can play a part in this.

One relevant documentary is The Corporation, the history of organizations and their growth in power is discussed. Corporate social responsibility, what a company does in trying to benefit society, versus corporate moral responsibility (CMR), what a company should morally do, are both important topics to consider when looking at ethics in CSR. For example, Ray Anderson, in

The Corporation, takes a CMR perspective in order to do what is moral and he begins to shift his company's focus towards the biosphere by utilizing carpets in sections so that they will sustain for longer periods. This is Anderson thinking in terms of Garret Hardin's "The Tragedy of the Commons," where if people do not pay attention to the private ways in which we use public resources, people will eventually lose those public resources.

Geography

In a geographical context, CSR is fundamentally an intangible populist idea without a conclusive definition. Corporations who employ CSR behaviors are empirically dissimilar in various parts of the world. The issue of CSR diversity is produced through the perpetual differences embedded in the social, political, cultural, and economic structures within individual countries. The immense geographical separations feasibly contribute to the loosely defined concept of CSR and difficulty for corporate regulation.

Public policies

CSR has inspired national governments to include CSR issues into their national public policy agendas. The increased importance driven by CSR, has prompted governments to promote socially and environmentally responsible corporate practices. Over the past decade governments have considered CSR as a public issue that requires national governmental involvement to address the very issues relevant to CSR. The heightened role of government in CSR has facilitated the development of numerous CSR programs and policies. Specifically, various European governments have implemented public policies on CSR enhancing their competence to develop sustainable corporate practices. CSR critics such as Robert Reich argue that governments should set the agenda for social responsibility by the way of laws and regulation that will allow a business to conduct themselves responsibly. Actors engaged in CSR:

- governments
- corporations
- civil societies

Recently when?, 15 European Union countries have actively engaged in CSR regulation and public policy development. Recognizably, the CSR efforts and policies are vastly different amongst countries resultant to the complexity and diversity of governments', corporations', and civil societies' roles. Scholars have analyzed each body that promotes CSR based policies and programs concluding that the role and effectiveness of these actors are case-specific.[60] Global issues so broadly defined such as CSR generate numerous relationships between the different socio-geographic players.

A key debate in CSR is determining what actors are responsible to ensure that corporation's are behaving in a socio-economic and environmentally sustainable manner.

Regulation

The issues surrounding corporate regulation pose several problems. The concept of regulation is inherently difficult to address because of the numerous corporations that exist are vastly dissimilar in terms of corporate behavior and nature. Thus, regulation in itself is unable to cover every aspect in detail of a corporation's operations. For example, This leads to burdensome legal processes bogged down in interpretations of the law and debatable grey areas (Sacconi 2004). For example, General Electric failed to clean up the Hudson River after contaminating it with organic pollutants. The company continues to argue via the legal process on assignment of liability, while the cleanup remains stagnant. (Sullivan & Schiafo 2005). Government regulation or public institutional regulation is difficult to achieve. Depending on the political regime and form of government – democracy, parliamentary, presidential – issues of governmental ineffectiveness may transpire. As a result, attempts at CSR policy development and implementation may be unattainable.

The second issue is the financial burden that regulation can place on a nation's economy. This view shared by Bulkeley, who cites the Australian federal government's actions to avoid compliance with the Kyoto Protocol in 1997, on the concerns of economic loss and national interest. The Australian government took the position that signing the Kyoto Pact would have caused more significant economic losses for Australia than for any other OECD nation (Bulkeley 2001, pg 436). On the change of government following the election in November 2007, Prime Minister Kevin Rudd signed the ratification immediately after assuming office on 3 December

2007, just before the meeting of the UN Framework Convention on Climate Change. Critics of CSR also point out that organizations pay taxes to government to ensure that society and the environment are not adversely affected by business activities.

The government of Canada has adopted a national position that expects Canadian corporations to practice behaviors parallel to CSR. In 2007, Prime Minister Harper was aware of Canada's abundant investment into the resource/mineral extractive sector and encouraged the Canadian mining companies to meet Canada's newly developed CSR standards and expectations. The method of developing and implementing CSR policies was achieved through government-company consultation and government stakeholder cooperation. The successful relationship between the CSR actors within Canada's government and country, may advocate that cooperation amongst constituencies is the most imperative element to CSR regulation.

The European Union has recently[when?] done extensive work to try and find the best form of regulation. Some critics argue that the creation of a CSR organization with a democratically appointed minister focused solely on monitoring and enforcing socially responsible behaviour will be extremely effective.

Laws

In the 1800s,the government in the primary establishment of corporate legislation could take away a firm's license if it acted socially irresponsible.This was due to corporations being viewed as "creatures of the state" under the law. However in 1819, The United States Supreme Court in the Dartmouth College vs. Woodward case established a corporation as an fictitious being.This new ruling not only allowed corporations to be protected under the Constitution but also limited states from enforcing restrictions on firms that did not act in the public good. The laws legally binding the corporation's behavior and activity are quite insignificant in relation to the global consequences. Only recently have countries included CSR policies in government agendas legislature. Common types of countries who have implemented legislation and CSR laws generally consist of socio-economic and politically sophisticated countries. The level of political stability and effectiveness is inextricably linked to a countries capacity to ensure national CSR policies.

The increasing ability and influence corporations have on the economic, political, and social dynamics of society correlate to the recent studies by the UN Commission on Human Rights.[64] More research and international political instruments are being explored to protect and prevent corporations from violating human rights.

Denmark has a law on CSR. On 16 December 2008, the Danish parliament adopted a bill making it mandatory for the 1100 largest Danish companies, investors and state-owned companies to include information on corporate social responsibility (CSR) in their annual financial reports. The reporting requirements became effective on 1 January 2009. The required information includes:

- information on the companies' policies for CSR or socially responsible investments (SRI)
- information on how such policies are implemented in practice, and
- information on what results have been obtained so far and managements expectations for the future with regard to CSR/SRI.

CSR/SRI is still voluntary in Denmark, but if a company has no policy on this it must state its positioning on CSR in their annual financial report. More on the Danish law can be found.

Crises and their consequences

Often it takes a crisis to precipitate attention to CSR. One of the most active stands against environmental mismanagement is the CERES Principles that resulted after the Exxon Valdez incident in Alaska in 1989 (Grace and Cohen 2006). Other examples include the lead poisoning paint used by toy giant Mattel, which required a recall of millions of toys globally and caused the company to initiate new risk management and quality control processes. In another example, Magellan Metals in the West Australian town of Esperance was responsible for lead contamination killing thousands of birds in the area. The company had to cease business immediately and work with independent regulatory bodies to execute a cleanup. Odwalla also experienced a crisis with sales dropping 90%, and the company's stock price dropping 34% due to several cases of E. coli spread through Odwalla apple juice. The company ordered a recall of all apple or carrot juice products and introduced a new process called "flash pasteurization" as well as maintaining lines of communication constantly open with customers.

Stakeholder priorities

Increasingly, corporations are motivated to become more socially responsible because their most important stakeholders expect them to understand and address the social and community issues that are relevant to them. Understanding what causes are important to employees is usually the first priority because of the many interrelated business benefits that can be derived from increased employee engagement (i.e. more loyalty, improved recruitment, increased retention, higher productivity, and so on). Key external stakeholders include customers, consumers, investors (particularly institutional investors), communities in the areas where the corporation operates its facilities, regulators, academics, and the media.

Branco and Rodrigues (2007) describe the stakeholder perspective of CSR as the inclusion of all groups or constituents (rather than just shareholders) in managerial decision making related to the organization’s portfolio of socially responsible activities. This normative model implies that the CSR collaborations are positively accepted when they are in the interests of stakeholders and may have no effect or be detrimental to the organization if they are not directly related to stakeholder interests. The stakeholder perspective suffers from a wheel and spoke network metaphor that does not acknowledge the complexity of network interactions that can occur in cross sector partnerships. It also relegates communication to a maintenance function, similar to the exchange perspective.

Industries considered void of CSR

Several industries are often absent from CSR research. The absence is due to the presumption that these particular industries fail to achieve ethical considerations of their consumers. Typical industries include tobacco and alcohol producers ("sin industry" manufacturers), as well as defense firms.

Chapter 7

Cross ownership

Cross ownership is a method of reinforcing business relationships by owning stock in the companies with which a given company does business. Heavy cross ownership is referred to as circular ownership.

In the US, "cross ownership" also refers to a type of investment in different mass-media properties in one market.

Cross ownership of stock

Some countries where cross ownership of shares is a major part of the business culture are:

- Japan
- Germany

Positives of cross ownership:

- Closely ties each business to the economic destiny of its business partners
- Promotes a slow rate of economic change

Cross ownership of shares is criticized for:

- Stagnating the economy
- Wasting capital that could be used to improve productivity
- Expanding economic downturns by preventing reallocation of capital

A major factor in perpetuating cross ownership of shares is a high capital gains tax rate. A company has less incentive to sell cross owned shares if taxes are high because of the immediate reduction in the value of the assets.

For example, a company owns $1000 of stock in another company that was originally purchased for $200. If the capital gains tax rate is 50% (like Germany) and the company sells the stock, the company has $600 which is 40 percent less than before it sold the stock.

Long term cross ownership of shares combined with a high capital tax rate greatly increases periods of asset deflation both in time and in severity.

Media cross ownership

Cross ownership also refers to a type of media ownership in which one type of communications (say a newspaper) owns or is the sister company of another type of medium (such as a radio or TV station). One example is The New York Times 's former ownership of WQXR Radio and the Chicago Tribune's similar relationship with WGN Radio (WGN-AM) and Television (WGN-TV).

The Federal Communications Commission generally does not allow cross ownership, to keep from one license holder having too much local media ownership, unless the license holder obtains a waiver, such as News Corporation and the Tribune Company have in New York.

The mid-1970s cross-ownership guidelines grandfathered already-existing crossownerships, such as Tribune-WGN, New York Times-WQXR and the New York Daily News ownership of WPIXTelevision and Radio.

Transactions with the company

By definition, where a director enters into a transaction with a company, there is a conflict between the director's interest (to do well for himself out of the transaction) and his duty to the company (to ensure that the company gets as much as it can out of the transaction). This rule is so strictly enforced that, even where the conflict of interest or conflict of duty is purely hypothetical, the directors can be forced to disgorge all personal gains arising from it. In Aberdeen Ry v Blaikie (1854) 1 Macq HL 461 Lord Cranworth stated in his judgment that:

"A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting or which possibly may conflict, with the interests of those whom he is bound to protect... So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of the contract entered into..."

However, in many jurisdictions the members of the company are permitted to ratify transactions which would otherwise fall foul of this principle. It is also largely accepted in most jurisdictions that this principle can be overridden in the company's constitution.

In many countries, there is also a statutory duty to declare interests in relation to any transactions, and the director can be fined for failing to make disclosure.

Use of corporate property, opportunity, or information

Directors must not, without the informed consent of the company, use for their own profit the company's assets, opportunities, or information. This prohibition is much less flexible than the prohibition against the transactions with the company, and attempts to circumvent it using provisions in the articles have met with limited success.

In Regal (Hastings) Ltd v Gulliver [1942] All ER 378 the House of Lords, in upholding what was regarded as a wholly unmeritorious claim by the shareholders, held that:

"(i) that what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in the utilisation of their opportunities and special knowledge as directors; and (ii) that what they did resulted in profit to themselves."

And accordingly, the directors were required to disgorge the profits that they made, and the shareholders received their windfall.

The decision has been followed in several subsequent cases, and is now regarded as settled law.

Competing with the company

Directors cannot compete directly with the company without a conflict of interest arising. Similarly, they should not act as directors of competing companies, as their duties to each company would then conflict with each other.

Common law duties of care and skill

Traditionally, the level of care and skill which has to be demonstrated by a director has been framed largely with reference to the non-executive director. In Re City Equitable Fire Insurance Co, it was expressed in purely subjective terms, where the court held that:

"a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience." (emphasis added)

However, this decision was based firmly in the older notions (see above) that prevailed at the time as to the mode of corporate decision making, and effective control residing in the shareholders; if they elected and put up with an incompetent decision maker, they should not have recourse to complain.

However, a more modern approach has since developed, and in Dorchester Finance Co Ltd v Stebbing [1989] BCLC 498 the court held that the rule in Equitable Fire related only to skill, and not to diligence. With respect to diligence, what was required was:

"such care as an ordinary man might be expected to take on his own behalf."

This was a dual subjective and objective test, and one deliberately pitched at a higher level.

More recently, it has been suggested that both the tests of skill and diligence should be assessed objectively and subjectively; in the United Kingdom, the statutory provisions relating to directors' duties in the new Companies Act 2006 have been codified on this basis.

Remedies for breach of duty

In most jurisdictions, the law provides for a variety of remedies in the event of a breach by the directors of their duties:

1. injunction or declaration
2. damages or compensation
3. restoration of the company's property
4. rescission of the relevant contract
5. account of profits
6. summary dismissal

The future

Historically, directors' duties have been owed almost exclusively to the company and its members, and the board was expected to exercise its powers for the financial benefit of the company. However, more recently there have been attempts to "soften" the position, and provide for more scope for directors to act as good corporate citizens. For example, in the United Kingdom, theCompanies Act 2006 requires directors of companies "to promote the success of the company for the benefit of its members as a whole" and sets out the following six factors regarding a director's duty to promote success:

- the likely consequences of any decision in the long term
- the interests of the company’s employees
- the need to foster the company’s business relationships with suppliers, customers and others
- the impact of the company’s operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of a company

This represents a considerable departure from the traditional notion that directors' duties are owed only to the company. Previously in the United Kingdom, under the Companies Act 1985, protections for non-member stakeholders were considerably more limited (see for example, s.309 which permitted directors to take into account the interests of employees but which could only be enforced by the shareholders and not by the employees themselves). The changes have therefore been the subject of some criticism.

United States

Sarbanes–Oxley Act

The Sarbanes–Oxley Act of 2002 has introduced new standards of accountability on boards of U.S. companies or companies listed on U.S. stock exchanges. Under the Act, directors risk large fines and prison sentences in the case of accounting crimes. Internal control is now the direct responsibility of directors. The vast majority of companies covered by the Act have hired internal auditors to ensure that the company adheres to required standards of internal control. The internal auditors are required by law to report directly to an audit board, consisting of directors more than half of whom are outside directors, one of whom is a "financial expert."

The law requires companies listed on the major stock exchanges (NYSE, NASDAQ) to have a majority of independent directors—directors who are not otherwise employed by the firm or in a business relationship with it.

Size

According to the Corporate Library's study, the average size of publicly traded company's board is 9.2 members, and most boards range from 3 to 31 members. According to Investopedia, some analysts think the ideal size is seven.

Committees

While a board may have several committees, two—the compensation committee and audit committee—are critical and must be made up of at least three independent directors and no inside directors. Other common committees in boards are nominating and governance.

Compensation

Directors of Fortune 500 companies received median pay of $234,000 in 2011. Directorship is a part-time job. A recent National Association of Corporate Directors study found directors averaging just 4.3 hours a week on board work.

Criticism

According to John Gillespie, a former investment banker and co-author of a book critical of boards, "Far too much of their time has been for check-the-box and cover-your-behind activities rather than real monitoring of executives and providing strategic advice on behalf of shareholders".

Chapter 8

Adverse selection

Adverse selection, anti-selection, or negative selection is a term used in economics, insurance, risk management, and statistics. It refers to a market process in which undesired results occur when buyers and sellers have asymmetric information (access to different information); the "bad" products or services are more likely to be selected. For example, a bank that sets one price for all of its chequing account customers runs the risk of being adversely selected against by its low-balance, high-activity (and hence least profitable) customers. Two ways to model adverse selection are to employ signaling games and screening games.

Insurance

The term adverse selection was originally used in insurance. It describes a situation wherein an individual's demand for insurance (the propensity to buy insurance and the quantity purchased) is positively correlated with the individual's risk of loss (higher risks buy more insurance), and the insurer is unable to allow for this correlation in the price of insurance. This may be because of private information known only to the individual (information asymmetry), or because of regulations or social norms which prevent the insurer from using certain categories of known information to set prices (for example, the insurer may be prohibited from using such information as gender, ethnic origin, genetic test results, or preexisting medical conditions, the last of which amount to a 100% risk of the losses associated with the treatment of that condition). The latter scenario is sometimes referred to as "regulatory adverse selection".

The potentially adverse nature of this phenomenon can be illustrated by the link between smoking status and mortality. Non-smokers, on average, are more likely to live longer, while smokers, on average, are more likely to die younger. If insurers do not vary prices for life insurance according to smoking status, life insurance will be a better buy for smokers than for non-smokers. So smokers may be more likely to buy insurance, or may tend to buy larger amounts, than non-smokers, thereby raising the average mortality of the combined policyholder group above that of the general population. From the insurer's viewpoint, the higher mortality of the group which selects to buy insurance is adverse. The insurer raises the price of insurance accordingly, and, as a consequence, non-smokers may be less likely to buy insurance (or may buy smaller amounts) than they would buy at a lower price reflective of their lower risk. The reduction in insurance purchases by non-smokers is also adverse from the insurer's viewpoint, and perhaps also from a public policy viewpoint.

Furthermore, if there is a range of increasing risk categories in the population, the increase in the insurance price because of adverse selection may lead the lowest remaining risks to cancel or not renew their insurance. This promotes a further increase in price, and hence the lowest remaining risks cancel their insurance, leading to a further price increase, and so on. Eventually this "adverse selection spiral" might, in theory, lead to the collapse of the insurance market.

To counter the effects of adverse selection, insurers (to the extent that laws permit) ask a range of questions and may request medical or other reports on individuals who apply to buy insurance so that the price quoted can be varied accordingly, and any unreasonably high or unpredictable risks rejected. This risk selection process is known as underwriting. In many countries, insurance law incorporates an "utmost good faith" or uberrima fides doctrine, which requires potential customers to answer any underwriting questions asked by the insurer fully and honestly; if they fail to do this, the insurer may later refuse to pay claims.

While adverse selection in theory seems an obvious and inevitable consequence of economic incentives, empirical evidence is mixed. Several studies investigating correlations between risk and insurance purchase have failed to show the predicted positive correlation for life insurance, auto insurance, and health insurance. On the other hand, "positive" test results for adverse selection have been reported in health insurance, long-term care insurance, and annuity markets. These "positive" results tend to be based on demonstrating more subtle relationships between risk and purchasing behavior (such as between mortality and whether the customer chooses a life annuity which is fixed or inflation-linked), rather than simple correlations of risk and quantity purchased.

One reason why adverse selection might be muted in practice could be that insurers' underwriting is largely effective. Another possible reason is the negative correlation between risk aversion(such as the willingness to purchase insurance) and risk level (estimated ex ante based on observation of the ex post occurrence rate of observed claims) in the population: if risk aversion is higher among lower risk customers, such that persons less likely to engage in risk-increasing behavior are more likely to engage in risk-decreasing behavior (to take affirmative steps to reduce risk), adverse selection can be reduced or even reversed, leading to "propitious" or "advantageous" selection.

For example, there is evidence that smokers are more willing to do risky jobs than non-smokers, and this greater willingness to accept risk might reduce insurance purchase by smokers. From a public policy viewpoint, some adverse selection can also be advantageous because it may lead to a higher fraction of total losses for the whole population being covered by insurance than if there were no adverse selection.

In studies of health insurance, an individual mandate that requires people to either purchase plans or face a penalty is cited as a way out of the adverse selection problem by broadening the risk pool. Mandates, like all insurance, increase moral hazard.

Common law duties of care and skill

Traditionally, the level of care and skill which has to be demonstrated by a director has been framed largely with reference to the non-executive director. In Re City Equitable Fire Insurance Co[1925] Ch 407, it was expressed in purely subjective terms, where the court held that:

"a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience." (emphasis added)

However, this decision was based firmly in the older notions (see above) that prevailed at the time as to the mode of corporate decision making, and effective control residing in the shareholders; if they elected and put up with an incompetent decision maker, they should not have recourse to complain.

However, a more modern approach has since developed, and in Dorchester Finance Co Ltd v Stebbing [1989] BCLC 498 the court held that the rule in Equitable Fire related only to skill, and not to diligence. With respect to diligence, what was required was:

"such care as an ordinary man might be expected to take on his own behalf."

This was a dual subjective and objective test, and one deliberately pitched at a higher level.

More recently, it has been suggested that both the tests of skill and diligence should be assessed objectively and subjectively; in the United Kingdom, the statutory provisions relating to directors' duties in the new Companies Act 2006 have been codified on this basis.

Remedies for breach of duty

In most jurisdictions, the law provides for a variety of remedies in the event of a breach by the directors of their duties:

1. injunction or declaration
2. damages or compensation
3. restoration of the company's property
4. rescission of the relevant contract
5. account of profits
6. summary dismissal

The future

Historically, directors' duties have been owed almost exclusively to the company and its members, and the board was expected to exercise its powers for the financial benefit of the company. However, more recently there have been attempts to "soften" the position, and provide for more scope for directors to act as good corporate citizens. For example, in the United Kingdom, the Companies Act 2006 requires directors of companies "to promote the success of the company for the benefit of its members as a whole" and sets out the following six factors regarding a director's duty to promote success:

- the likely consequences of any decision in the long term
- the interests of the company’s employees

- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of a company

This represents a considerable departure from the traditional notion that directors' duties are owed only to the company. Previously in the United Kingdom, under the Companies Act 1985, protections for non-member stakeholders were considerably more limited (see for example, s.309 which permitted directors to take into account the interests of employees but which could only be enforced by the shareholders and not by the employees themselves). The changes have therefore been the subject of some criticism.

United States

Sarbanes–Oxley Act

The Sarbanes–Oxley Act of 2002 has introduced new standards of accountability on boards of U.S. companies or companies listed on U.S. stock exchanges. Under the Act, directors risk large fines and prison sentences in the case of accounting crimes. Internal control is now the direct responsibility of directors. The vast majority of companies covered by the Act have hired internal auditors to ensure that the company adheres to required standards of internal control. The internal auditors are required by law to report directly to an audit board, consisting of directors more than half of whom are outside directors, one of whom is a "financial expert."

The law requires companies listed on the major stock exchanges (NYSE, NASDAQ) to have a majority of independent directors—directors who are not otherwise employed by the firm or in a business relationship with it.

Size

According to the Corporate Library's study, the average size of publicly traded company's board is 9.2 members, and most boards range from 3 to 31 members. According to Investopedia, some analysts think the ideal size is seven.

Committees

While a board may have several committees, two—the compensation committee and audit committee—are critical and must be made up of at least three independent directors and no inside directors. Other common committees in boards are nominating and governance.

Compensation

Directors of Fortune 500 companies received median pay of $234,000 in 2011. Directorship is a part-time job. A recent National Association of Corporate Directors study found directors averaging just 4.3 hours a week on board work

Criticism

According to John Gillespie, a former investment banker and co-author of a book critical of boards, "Far too much of their time has been for check-the-box and cover-your-behind activities rather than real monitoring of executives and providing strategic advice on behalf of shareholders".

Chapter 9

Corporate group

A corporate group (or a "group of companies") is a collection of parent and subsidiary corporations that function as a single economic entity through a common source of control. The concept of a group is frequently used in tax law, accounting and (less frequently) company law to attribute the rights and duties of one member of the group to another or the whole. If the corporations are engaged in entirely different businesses, the group is called a conglomerate. The forming of corporate groups usually involves consolidation via mergers and acquisitions, although the group concept focuses on the instances in which the merged and acquired corporate entities remain in existence rather than the instances in which they are dissolved by the parent.

In Germany, where a sophisticated law of the "concern" has been developed, the law of corporate groups is a fundamental aspect of its corporate law. Many other European jurisdictions also have a similar approach, while Commonwealth countries and the United States adhere to a formalistic doctrine that refuses to "pierce the corporate veil": corporations are treated outside tax and accounting as wholly separate legal entities.

Legal independence

- Salomon v Salomon
- Berkey v Third Avenue Railway

Economic dependence

- Concern (business)
- DHN v Tower Hamlets LBC
- EU Seventh Company Law Directive 83/349, on group accounts
- EU Draft Ninth Company Law Directive, on corporate groups

Law

Tax

Accounting

- EU Seventh Company Law Directive 83/349, on group accounts
- Civil law
- Salomon v Salomon
- Berkey v Third Avenue Railway
- Adams v Cape Industries plc

Definition

The definition of business group varies. For instance, Leff defines business group as a group of companies that does business in different markets under common administrative or financial control whose members are linked by relations of interpersonal trust on the basis of similar personal ethnic or commercial background. One method of defining a group is as a cluster of legally distinct firms with a managerial relationship. The relationship between the firms in a group may be formal or informal. A keiretsu is one type of business group. A concern is another.

Encarnation refers to Indian business houses, emphasizing multiple forms of ties among group members. Powell and Smith-Doerr state that a business group is a network of firms that regularly collaborate over a long time period. Granovetter argues that business groups refers to an intermediate level of binding, excluding on the one hand a set of firms bound merely by short-term alliances and on the other a set of firms legally consolidated into a single unit. Williamson claims that business groups lie between markets and hierarchies; this is further worked out byDouma & Schreuder. Khanna and Rivkin suggest that business groups are typically not legal constructs though some regulatory bodies have attempted to codify a definition. In the United Arab Emirates, a business group can also be known as a trade association. Typical examples are Adidas Group or Icelandair Group.

Regulation

The issues surrounding corporate regulation pose several problems. The concept of regulation is inherently difficult to address because of the numerous corporations that exist are vastly dissimilar in terms of corporate behavior and nature. Thus, regulation in itself is unable to cover every aspect in detail of a corporation's operations. For example, This leads to burdensome legal processes bogged down in interpretations of the law and debatable grey areas (Sacconi 2004). For example, General Electric failed to clean up the Hudson River after contaminating it with organic pollutants. The company continues to argue via the legal process on assignment of liability, while the cleanup remains stagnant. (Sullivan & Schiafo 2005). Government regulation or public institutional regulation is difficult to achieve. Depending on the political regime and form of government – democracy, parliamentary, presidential – issues of governmental ineffectiveness may transpire. As a result, attempts at CSR policy development and implementation may be unattainable.

The second issue is the financial burden that regulation can place on a nation's economy. This view shared by Bulkeley, who cites the Australian federal government's actions to avoid compliance with the Kyoto Protocol in 1997, on the concerns of economic loss and national interest. The Australian government took the position that signing the Kyoto Pact would have caused more significant economic losses for Australia than for any other OECD nation (Bulkeley 2001, pg 436). On the change of government following the election in November 2007, Prime Minister Kevin Rudd signed the ratification immediately after assuming office on 3 December 2007, just before the meeting of the UN Framework Convention on Climate Change. Critics of CSR also point out that organizations pay taxes to government to ensure that society and the environment are not adversely affected by business activities.

The government of Canada has adopted a national position that expects Canadian corporations to practice behaviors parallel to CSR. In 2007, Prime Minister Harper was aware of Canada’s abundant investment into the resource/mineral extractive sector and encouraged the Canadian mining companies to meet Canada’s newly developed CSR standards and expectations. The method of developing and implementing CSR policies was achieved through government-company consultation and government stakeholder cooperation. The successful relationship between the CSR actors within Canada’s government and country, may advocate that cooperation amongst constituencies is the most imperative element to CSR regulation.

The European Union has recently done extensive work to try and find the best form of regulation. Some critics argue that the creation of a CSR organization with a democratically appointed minister focused solely on monitoring and enforcing socially responsible behaviour will be extremely effective.

Laws

In the 1800s,the government in the primary establishment of corporate legislation could take away a firm's license if it acted socially irresponsible.This was due to corporations being viewed as "creatures of the state" under the law. However in 1819, The United States Supreme Court in the Dartmouth College vs. Woodward case established a corporation as an fictitious being.This new ruling not only allowed corporations to be protected under the Constitution but also limited states from enforcing restrictions on firms that did not act in the public good.[63] The laws legally binding the corporation’s behavior and activity are quite insignificant in relation to the global consequences. Only recently have countries included CSR policies in government agendas legislature. Common types of countries who have implemented legislation and CSR laws generally consist of socio-economic and politically sophisticated countries. The level of political stability and effectiveness is inextricably linked to a countries capacity to ensure national CSR policies.

The increasing ability and influence corporations have on the economic, political, and social dynamics of society correlate to the recent studies by the UN Commission on Human Rights. More research and international political instruments are being explored to protect and prevent corporations from violating human rights.

Denmark has a law on CSR. On 16 December 2008, the Danish parliament adopted a bill making it mandatory for the 1100 largest Danish companies, investors and state-owned companies to include information on corporate social responsibility (CSR) in their annual financial reports. The reporting requirements became effective on 1 January 2009. The required information includes:

- information on the companies' policies for CSR or socially responsible investments (SRI)
- information on how such policies are implemented in practice, and
- information on what results have been obtained so far and managements expectations for the future with regard to CSR/SRI.

CSR/SRI is still voluntary in Denmark, but if a company has no policy on this it must state its positioning on CSR in their annual financial report. More on the Danish law can be found at CSRgov.dk

Crises and their consequences

Often it takes a crisis to precipitate attention to CSR. One of the most active stands against environmental mismanagement is the CERES Principles that resulted after the Exxon Valdez incident in Alaska in 1989 (Grace and Cohen 2006). Other examples include the lead poisoning paint used by toy giant Mattel, which required a recall of millions of toys globally and caused the company to initiate new risk management and quality control processes. In another example, Magellan Metals in the West Australian town of Esperance was responsible for lead contamination killing thousands of birds in the area. The company had to cease business immediately and work with independent regulatory bodies to execute a cleanup. Odwalla also experienced a crisis with sales dropping 90%, and the company's stock price dropping 34% due to several cases of E. coli spread through Odwalla apple juice. The company ordered a recall of all apple or carrot juice products and introduced a new process called "flash pasteurization" as well as maintaining lines of communication constantly open with customers.

Stakeholder priorities

Increasingly, corporations are motivated to become more socially responsible because their most important stakeholders expect them to understand and address the social and community issues that are relevant to them. Understanding what causes are important to employees is usually the first priority because of the many interrelated business benefits that can be derived from increased employee engagement (i.e. more loyalty, improved recruitment, increased retention, higher productivity, and so on). Key external stakeholders include customers, consumers, investors (particularly institutional investors), communities in the areas where the corporation operates its facilities, regulators, academics, and the media.

Branco and Rodrigues (2007) describe the stakeholder perspective of CSR as the inclusion of all groups or constituents (rather than just shareholders) in managerial decision making related to the organization's portfolio of socially responsible activities. This normative model implies that the CSR collaborations are positively accepted when they are in the interests of stakeholders and may have no effect or be detrimental to the organization if they are not directly related to stakeholder interests. The stakeholder perspective suffers from a wheel and spoke network metaphor that does not acknowledge the complexity of network interactions that can occur in cross sector partnerships. It also relegates communication to a maintenance function, similar to the exchange perspective.

Industries considered void of CSR

Several industries are often absent from CSR research. The absence is due to the presumption that these particular industries fail to achieve ethical considerations of their consumers. Typical industries include tobacco and alcohol producers ("sin industry" manufacturers), as well as defence firms

Recently, 15 European Union countries have actively engaged in CSR regulation and public policy development.[61] Recognizably, the CSR efforts and policies are vastly different amongst countries resultant to the complexity and diversity of governments', corporations', and civil societies' roles. Scholars have analyzed each body that promotes CSR based policies and programs concluding that the role and effectiveness of these actors are case-specific.[60] Global issues so broadly defined such as CSR generate numerous relationships between the different socio-geographic players.

A key debate in CSR is determining what actors are responsible to ensure that corporation's are behaving in a socio-economic and environmentally sustainable manner.

Chapter 10

Knowledge economy

The knowledge economy is the use of knowledge (savoir, savoir-faire, savoir-etre) to generate tangible and intangible values. Technology and in particular knowledge technology (Artificial Intelligence) help to transform a part of human knowledge to machines. This knowledge can be used by decision support systems in various fields and generate economic values. Knowledge economy is also possible without technology.

The use of knowledge technologies (such as knowledge engineering and knowledge management) to produce economic benefits as well as job creation is only one facet of Knowledge Economy. The phrase was popularized by Peter Drucker as the title of Chapter 12 in his book The Age of Discontinuity, And, with a footnote in the text, Drucker attributes the phrase to economist Fritz Machlup and its origins to the idea of "scientific management" developed by Frederick Winslow Taylor.

Other than the agricultural-intensive economies and labor-intensive economies, the global economy is in transition to a "knowledge economy", as an extension of an "information society" in the Information Age led by innovation, such as providing the development platform for engineering physics. The transition requires that the rules and practices that determined success in the industrial economy need rewriting in an interconnected, globalized economy where knowledge resources such as know-how and expertise are as critical as other economic resources.

Concepts

A key concept of the knowledge economy is that knowledge and education (often referred to as "human capital") can be treated as one of the following two:

- A business product, as educational and innovative intellectual products and services can be exported for a high value return.

- A productive asset
- It can be defined as

"The concept that supports creation of knowledge by organizational employees and helps and encourages them to transfer and better utilize their knowledge that is in line with company/organization goals."

The initial foundation for the knowledge economy was introduced in 1966 in the book The Effective Executive by Peter Drucker. In this book, Drucker described the difference between the manual worker and the knowledge worker. The manual worker, according to him, works with his or her hands and produces goods or services. In contrast, a knowledge worker works with his or her head, not hands, and produces ideas, knowledge, and information.

The key problem in the formalization and modeling of knowledge economy is a vague definition of knowledge, which is a rather relative concept. For example, it is not proper to consider information society as interchangeable with knowledge society. Information is usually not equivalent to knowledge. Their use, as well, depends on individual and group preferences (see the cognitive IPK model) which are "economy-dependent".

Evolution

The knowledge economy is also seen as the latest stage of development in global economic restructuring. Thus far, the developed world has transitioned from an agricultural economy (pre-Industrial Age, largely the agrarian sector) to industrial economy (with the Industrial Age, largely the manufacturing sector) to post-industrial/mass production economy (mid-1900s, largely theservice sector) to knowledge economy (late 1900s – 2000s, largely the technology/human capital sector). This latest stage has been marked by the upheavals in technological innovations and the globally competitive need for innovation with new products and processes that develop from the research community (i.e., R&D factors, universities, labs, educational institutes).

In the knowledge economy, the specialized labor force is characterized as computer literate and well-trained in handling data, developing algorithms and simulated models, and innovating on processes and systems. Harvard Business School Professor, Michael Porter asserts that today's economy is far more dynamic and that comparative advantage is less relevant than competitive advantage which rests on “making more productive use of inputs, which requires continual innovation". Consequently, the technical, STEM careers including computer scientists, engineers, chemists, biologists, mathematicians, and scientific inventors will see continuous demand in years to come. Additionally, well-situated clusters, which Michael Porter argues is vital in global economies, connect locally with linked industries, manufacturers, and other entities that are related by skills, technologies, and other common inputs. Hence, knowledge is the catalyst and connective tissue in modern economies.

With earth’s depleting natural resources, the need for green infrastructure, a logistics industry forced into just-in-time deliveries, growing global demand, regulatory policy governed by performance results, and a host of other items high priority is put on knowledge; and research becomes paramount. Knowledge provides the technical expertise, problem-solving, performance measurement and evaluation, and data management needed for the transboundary, interdisciplinary global scale of today’s competition.

Worldwide examples of the knowledge economy taking place among many others include: Silicon Valley in California; aerospace and automotive engineering in Munich, Germany; biotechnology in Hyderabad, India; electronics and digital media in Seoul, South Korea; petrochemical and energy industry in Brazil.

It has been suggested that the next evolutionary step after knowledge economy is the network economy, where the relatively localized knowledge is now being shared among and across various networks for the benefit of the network members as a whole, to gain economic of scale in a wider, more open scale.

Driving forces

Commentators suggest there are various interlocking driving forces, which are changing the rules of business and national competitiveness:

- Globalization — markets and products are more global.
- Information technology, which is related to next three:

- Information/Knowledge Intensity — efficient production relies on information and know-how; over 70 per cent of workers in developed economies are information workers; many factory workers use their heads more than their hands.
- New Media – New media increases the production and distribution of knowledge which in turn, results in collective intelligence. Existing knowledge becomes much easier to access as a result of networked data-bases which promote online interaction between users and producers.
- Computer networking and Connectivity – developments such as the Internet bring the "global village" ever nearer.

As a result, goods and services can be developed, bought, sold, and in many cases even delivered over electronic networks.

As regards the applications of any new technology, this depends on how it meets economic demand. It can remain dormant or make a commercial breakthrough (see diffusion of innovation).

Characteristics

- It can be argued that the knowledge economy differs from the traditional economy in several key respects:
- The economics are not of scarcity, but rather of abundance. Unlike most resources that become depleted when used, information and knowledge can be shared, and actually grow through application.
- The effect of location is either
- diminished, in some economic activities: using appropriate technology and methods, virtual marketplaces and virtual organizations that offer benefits of speed, agility, round the clock operation and global reach can be created.

- or, on the contrary, reinforced in some other economic fields, by the creation of business clusters around centres of knowledge, such as universities and research centres. However, clusters already existed in pre-knowledge economy times.
- Laws, barriers, taxes and ways to measure are difficult to apply solely on a national basis. Knowledge and information "leak" to where demand is highest and the barriers are lowest.
- Knowledge enhanced products or services can command price premiums over comparable products with low embedded knowledge or knowledge intensity.
- Pricing and value depends heavily on context. Thus the same information or knowledge can have vastly different value to different people, or even to the same person at different times.
- Knowledge when locked into systems or processes has higher inherent value than when it can "walk out of the door" in people's heads.
- Human capital — competencies — are a key component of value in a knowledge-based company, yet few companies report competency levels in annual reports. In contrast, downsizing is often seen as a positive "cost cutting" measure.
- Communication is increasingly being seen as fundamental to knowledge flows. Social structures, cultural context and other factors influencing social relations are therefore of fundamental importance to knowledge economies.

These characteristics require new ideas and approaches from policy makers, managers and knowledge workers.

The knowledge economy has manifold forms in which it may appear but there are predictions that the new economy will extend radically, creating a pattern in which even ideas will be recognised and identified as a commodity. This certainly is not the best time to make any hasty judgment on this contention, but considering the very nature of 'knowledge' itself, added to the fact that it is the thrust of this new form of economy, there certainly is a clear way forward for this notion, though the particulars (i.e. the quantum of the revolutionary approach and its applicability and commercial value),remain in the speculative realm, as of now.

Technology

The technology requirements for an Innovative System as described by the World Bank Institute must be able to disseminate a unified process by which a working method may converge scientific and technology solutions, and organizational solutions. According to the World Bank Institute‘s definition, such innovation would further enable the World Bank Institute‘s vision outlined in their Millennium Development Goals.

Challenges for Developing Countries

The United Nations Commission on Science and Technology for Development report (UNCSTD, 1997) concluded that for developing countries to successfully integrate ICTs and sustainable development in order to participate in the knowledge economy they need to intervene collectively and strategically. Such collective intervention suggested would be in the development of effective national ICT policies that support the new regulatory framework, promote the selected knowledge production, and use of ICTs and harness their organizational changes to be in line with the Millennium Development Goals. The report further suggests that developing countries to develop the required ICT strategies and policies for institutions and regulations taking into account the need to be responsive to the issues of convergence.

The growth of the Internet, and particularly distributed search engines like Kazaa and Gnutella, have represented a challenge for copyright policy. TheRecording Industry Association of America, in particular, has been on the front lines of the fight against copyright infringement, which the industry calls "piracy". The industry has had victories against some services, including a highly publicized case against the file-sharing company Napster, and some people have been prosecuted for sharing files in violation of copyright. The electronic age has seen an increase in the attempt to use software-based digital rights management tools to restrict the copying and use of digitally based works. Laws such as the Digital Millennium Copyright Act have been enacted, that use criminal law to prevent any circumvention of software used to enforce digital rights management systems. Equivalent provisions, to prevent circumvention of copyright protection have existed in EU for some time, and are being expanded in, for example, Article 6 and 7 the

Copyright Directive. Other examples are Article 7 of the Software Directive of 1991 (91/250/EEC), and the Conditional Access Directive of 1998 (98/84/EEC). This can hinder legal uses, affecting public domain works, limitations and exceptions to copyright, or uses allowed by the copyright holder. Some copy leftlicenses, like GNU GPL 3, are designed to counter that. Laws may permit circumvention under specific conditions like when it is necessary to achieve interoperability with the circumventor’s program, or for accessibility reasons; however, distribution of circumvention tools or instructions may be illegal.

In the context of trademarks, this expansion has been driven by international efforts to harmonise the definition of "trademark", as exemplified by the Agreement on Trade-Related Aspects of Intellectual Property Rights ratified in 1994, which formalized regulations for IP rights that had been handled by common law, or not at all, in member states. Pursuant to TRIPs, any sign which is "capable of distinguishing" the products or services of one business from the products or services of another business is capable of constituting a trademark.

Chapter 11

Executive compensation

Executive compensation (also executive pay), is composed of the financial compensation and other non-financial awards received by an executive of a firm. It is typically a mixture of salary, bonuses, shares of and/or call options on the company stock, benefits, and perquisites, ideally configured to take into account government regulations, tax law, the desires of the organization and the executive, and rewards for performance.

The three decades starting with the 1980s, saw a dramatic rise in executive pay relative to that of an average worker's wage in the United States, and to a lesser extent in a number of other countries. Observers differ as to whether this rise is a natural and beneficial result of competition for scarce business talent that can add greatly to stockholder value in large companies, or a socially harmful phenomenon brought about by social and political changes that have given executives greater control over their own pay. Executive pay is an important part of corporate governance, and is often determined by a company's board of directors.

In a modern corporation, the CEO and other top executives are often paid salary plus short-term incentives or bonuses. This combination is referred to as Total Cash Compensation (TCC). Short-term incentives usually are formula-driven and have some performance criteria attached depending on the role of the executive. For example, the Sales Director's performance related bonus may be based on incremental revenue growth turnover; a CEO's could be based on incremental profitability and revenue growth. Bonuses are after-the-fact (not formula driven) and often discretionary. Executives may also be compensated with a mixture of cash and shares of the company which are almost always subject to vesting restrictions (a long-term incentive). To be considered a long-term incentive the measurement period must be in excess of one year (3–5 years is common). The vesting term refers to the period of time before the recipient has the right to transfer shares and realize value. Vesting can be based on time, performance or both. For example a CEO might get 1 million in cash, and 1 million in company shares (and share buy options used). Vesting can occur in two ways: "cliff vesting" (vesting occurring on one date), and "graded vesting" (which occurs over a period of time) and which maybe "uniform" (e.g., 20% of the options vest each year for 5 years) or "non-uniform" (e.g., 20%, 30% and 50% of the options vest each year for the next three years). Other components of an executive compensation package may include such perks as generous retirement plans, health insurance, a chauffeured limousine, an executive jet, and interest-free loans for the purchase of housing.

Stock options

Executive stock option pay rose dramatically in the United States after scholarly support from University of Chicago educated Professors Michael C. Jensen and Kevin J. Murphy. Due to their publications in the Harvard Business Review 1990 and support from Wall Street and institutional investors, Congress passed a law making it cost effective to pay executives in equity.

Supporters of stock options say they align the interests of CEOs to those of shareholders, since options are valuable only if the stock price remains above the option's strike price. Stock options are now counted as a corporate expense (non-cash), which impacts a company's income statement and makes the distribution of options more transparent to shareholders. Critics of stock options charge that they are granted without justification as there is little reason to align the interests of CEOs with those of shareholders. Empirical evidence shows since the wide use of stock options, executive pay relative to workers has dramatically risen. Moreover, executive stock options contributed to the accounting manipulation scandals of the late 1990s and abuses such as the options backdating of such grants. Finally, researchers have shown that relationships between executive stock options and stock buybacks, implying that executives use corporate resources to inflate stock prices before they exercise their options.

Stock options also incentivize executives to engage in risk-seeking behavior. This is because the value of a call option increases with increased volatility (see options pricing). Stock options also present a potential up-side gain (if the stock price goes up) for the executive, but no downside risk (if the stock price goes down, the option simply isn't exercised). Stock options therefore can incentivize excessive risk seeking behavior that can lead to catastrophic corporate failure.

Restricted stock

Executives are also compensated with restricted stock, which is stock given to an executive that cannot be sold until certain conditions are met and has the same value as the market price of the stock at the time of grant. As the size of stock option grants have been reduced, the number of companies granting restricted stock either with stock options or instead of, has increased. Restricted stock has its detractors, too, as it has value even when the stock price falls. As an alternative to straight time vested restricted stock, companies have been adding performance type features to their grants. These grants, which could be called performance shares, do not vest or are not granted until these conditions are met. These performance conditions could be earnings per share or internal financial targets.

Levels of compensation

The levels of compensation in all countries has been rising dramatically over the past decades. Not only is it rising in absolute terms, but also in relative terms. In 2007, the world's highest paid chief executive officers and chief financial officers were American. They made 400 times more than average workers—a gap 20 times bigger than it was in 1965. In 2010 the highest paid CEO was Viacom's Philippe P. Dauman at $84.5 million The U.S. has the world's highest CEO's compensation relative to manufacturing production workers. According to one 2005 estimate the U.S. ratio of CEO's to production worker pay is 39:1 compared to 31.8:1 in UK; 25.9:1 in Italy; 24.9:1 in New Zealand.

Controversy

The explosion in executive pay has become controversial, criticized by not only leftists but conservative establishmentarians such as Ben Bernanke

Peter Drucker, John Bogle,

Warren Buffett.

The idea that stock options and other alleged pay-for-performance are driven by economics has also been questioned. According to economist Paul Krugman, "Today the idea that huge paychecks are part of a beneficial system in which executives are given an incentive to perform well has become something of a sick joke. A 2001 article in Fortune, "The Great CEO Pay Heist" encapsulated the cynicism: You might have expected it to go like this: The stock isn't moving, so the CEO shouldn't be rewarded. But it was actually the opposite: The stock isn't moving, so we've got to find some other basis for rewarding the CEO.` And the article quoted a somewhat repentant Michael Jensen `I've generally worried these guys weren't getting paid enough. But now even I'm troubled.'

Defenders of high executive pay say that the global war for talent and the rise of private equity firms can explain much of the increase in executive pay. For example, while in conservative Japan a senior executive has few alternatives to his current employer, in the United States it is acceptable and even admirable for a senior executive to jump to a competitor, to a private equity firm, or to a private equity portfolio company. Portfolio company executives take a pay cut but are routinely granted stock options for ownership of ten percent of the portfolio company, contingent on a successful tenure. Rather than signaling a conspiracy, defenders argue, the increase in executive pay is a mere byproduct of supply and demand for executive talent. However, U.S. executives make substantially more than their European and Asian counterparts.

United States

Source: Economic Policy Institute. 2011.

The U.S. Securities and Exchange Commission (SEC) has asked publicly traded companies to disclose more information explaining how their executives' compensation amounts are determined. The SEC has also posted compensation amounts on its website to make it easier for investors to compare compensation amounts paid by different companies. It is interesting to juxtapose SEC regulations related to executive compensation with Congressional efforts to address such compensation.

Since the 1990s, CEO compensation in the US has outpaced corporate profits, economic growth and the average compensation of all workers. Between 1980 and 2004, Mutual Fund founder John Bogle estimates total CEO compensation grew 8.5%/year compared, compared to corporate profit growth of 2.9%/year and per capita income growth of 3.1%. By 2006 CEOs made 400 times more than average workers—a gap 20 times bigger than it was in 1965. As a general rule, the larger the corporation the larger the CEO compensation package.

The share of corporate income devoted to compensating the five highest paid executives of (each) public firms more than doubled from 4.8% in 1993-1995 to 10.3% in 2001-2003. The pay for the five top-earning executives at each of the largest 1500 American companies for the ten years from 1994 to 2004 is estimated at approximately $500 billion in 2005 dollars.

As of late March 2012 USA Today's tally showed the median CEO pay of the S&P 500 for 2011 was $9.6 million.

Lower level executives also have fared well. About 40% of the top 0.1% income earners in the United States are executives, managers, or supervisors (and this doesn't include the finance industry) — far out of proportion to less than 5% of the working population that management occupations make up.

A study by University of Florida researchers found that highly paid CEOs improve company profitability as opposed to executives making less for similar jobs.

On the other hand, a study by Professors Lynne M. Andersson and Thomas S. Batemann published in the Journal of Organizational Behavior found that highly paid executives are more likely to behave cynically and therefore show tendencies of unethical performance.

Australia

In Australia, shareholders can vote against the pay rises of board members, but the vote is non-binding. Instead the shareholders can sack some or all of the board members.

Canada

A 2012 report by the Canadian Centre for Policy Alternatives complained that the top 100 Canadian CEOs were paid an average of C$8.4 million in 2010, a 27% increase over 2009, this compared to C$44,366 earned by the average Canadian that year, 1.1% more than in 2009. The top three earners were automotive supplier Magna International Inc. founder Frank Stronach at

C$61.8 million, co-CEO Donald Walker at C$16.7 million and former co-CEO Siegfried Wolf at C$16.5 million.

Europe

In 2008, Jean-Claude Juncker, president of the European Commission's “Eurogroup” of finance ministers, called excessive pay a “social scourge” and demanded action.

United Kingdom

Although executive compensation in the UK is said to be "dwarfed" by that of corporate America, it has caused public upset. In response to criticism of high levels of executive pay, the Compass organisation set up the High Pay Commission. Its 2011 report described the pay of executives as "corrosive".

In December 2011/January 2012 two of the country’s biggest investors, Fidelity Worldwide Investment, and the Association of British Insurers, called for greater shareholder control over executive pay packages. Dominic Rossi of Fidelity Worldwide Investment stated, “Inappropriate levels of executive reward have destroyed public trust and led to a situation where all directors are perceived to be overpaid. The simple truth is that remuneration schemes have become too complex and, in some cases, too generous and out of line with the interests of investors.” Two sources of public anger were Barclays, where senior executives were promised million-pound pay packages despite a 30% drop in share price; and Royal Bank of Scotland where the head of investment banking was set to earn a "large sum" after thousands of employees were made redundant.

Regulation

There are a number of strategies that could be employed as a response to the growth of executive compensation.

- As passed in the Swiss referendum "against corporate Rip-offs" of 2013, investors gain total control over executive compensation, and the executives of a board of directors.

Institutional intermediaries must all vote in the interests of their beneficiaries and banks are prohibited from voting on behalf of investors.

- Disclosure of salaries is the first step, so that company stakeholders can know and decide whether or not they think remuneration is fair. In the UK, the Directors' Remuneration Report Regulations 2002 introduced a requirement into the old Companies Act 1985, the requirement to release all details of pay in the annual accounts. This is now codified in the Companies Act 2006. Similar requirements exist in most countries, including the U.S., Germany, and Canada.

- A say on pay - a non-binding vote of the general meeting to approve director pay packages, is practised in a growing number of countries. Some commentators have advocated a mandatory binding vote for large amounts (e.g. over $5 million).[32] The aim is that the vote will be a highly influential signal to a board to not raise salaries beyond reasonable levels. The general meeting means shareholders in most countries. In most European countries though, with two-tier board structures, a supervisory board will represent employees and shareholders alike. It is this supervisory board which votes on executive compensation.

- Another proposed reform is the bonus-malus system, where executives carry down-side risk in addition to potential up-side reward.

- Progressive taxation is a more general strategy that affects executive compensation, as well as other highly paid people. There has been a recent trend to cutting the highest bracket tax payers, a notable example being the tax cuts in the U.S. For example, the Baltic States have a flat tax system for incomes. Executive compensation could be checked by taxing more heavily the highest earners, for instance by taking a greater percentage of income over $200,000.

- Maximum wage is an idea which has been enacted in early 2009 in the United States, where they capped executive pay at $500,000 per year for companies receiving extraordinary financial assistance from the U.S. taxpayers. The argument is to place a cap on the amount that any person may legally make, in the same way as there is a floor of a minimum wage so that people can not earn too little.

- Debt Like Compensation - It has been widely accepted that the risk taking motivation of executives depends on its position in equity based compensation and risky debt. Adding debt like instrument as part of an executive compensation may reduce the risk taking motivation of executives. Therefore, as of 2011, there are several proposals to enforce financial institutions to use debt like compensation.
- Indexing Operating Performance is a way to make bonus targets business cycle independent. Indexed bonus targets move with the business cycle and are therefore fairer and valid for a longer period of time.

- Two strikes - In Australia an amendment to the Corporations Amendment(Improving Accountability on Director and Executive Remuneration) Bill 2011 puts in place processes to trigger a re-election of a Board where a 25% "no" vote by shareholders to the company's remuneration report has been recorded in two consecutive annual general meetings. When the second "no" vote is recorded at an AGM, the meeting will be suspended and shareholders will be asked to vote on whether a spill meeting is to be held. This vote must be upheld by at least a 50% majority for the spill (or re-election process) to be run. At a spill meeting all directors current at the time the remuneration report was considered are required to stand for re-election.

- Independent non-executive director setting of compensation is widely practised. An independent remuneration committee is an attempt to have pay packages set at arms' length from the directors who are getting paid.

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