Corporate Governance: An Ethical Perspective

Surendra Arjoon
Department of Management Studies
The University of the West Indies
St. Augustine, Trinidad
Phone: 868-645-3232 ext 2105
Fax: 868-662-1140
E-mail: sarjoon@fss.uwi.tt

Abstract

This paper discusses corporate governance issues from a compliance viewpoint. It makes a distinction between legal and ethical compliance mechanisms and shows that the former has clearly proven to be inadequate as it lacks the moral firepower to restore confidence and the ability to build trust. The concepts of *freedom of indifference* and *freedom for excellence* provide a theoretical basis for explaining why legal compliance mechanisms are insufficient in dealing with fraudulent practices and may not be addressing the real and fundamental issues that inspire ethical behavior. Ethical compliance mechanisms are addressed from a virtue ethics perspective, in particular, the role of the cardinal virtues in governance is discussed. Some graphical points of reflection on the cardinal virtues from the works of Saint Josemaría Escrivá, who was known for his outstanding capacity for organization and governance, are presented. The tendency to overemphasize legal compliance mechanisms may result in an attempt to substitute "*accountability*" for "*responsibility*" and may also result in an attempt to legislate morality. The focus of the virtues in governance is to establish a series of practical responses which depend on the consistent application of core values and principles as well as commitment to ethical business practice

Key words: Corporate Governance, Virtue Ethics, Natural Law Ethics, Compliance Mechanisms, Cardinal Virtues.

1. Introduction

Over the last two decades, corporate governance has attracted a great deal of public interest because of its apparent importance for the economic health of corporations and society in general. The headlines of the previous two years in particular portrayed a sad story of corporate ethics (or lack thereof): WorldCom, Anderson, Merrill Lynch, Enron, Martha Stewart, Global Crossing, Qwest Communications, Tyco International, Adelphia Communications, Computer Associates, Parmalat, Putnam, Boeing, Rite Aid, Xerox ... Falling stock markets, corporate failures, dubious accounting practices, abuses of corporate power, criminal investigations indicate that the entire economic system upon which investment returns have depended is showing signs of stress that have undermined investor's confidence. Some corporations have grown dramatically in a relatively short time through acquisitions funded by inflated share prices and promises of even brighter futures (many of these corporations have now failed). In others, it seems as if the checks and balances that should protect shareholder interests were pushed to one side, driven by a perception of the need to move fast in the pursuit of the bottom line. While some failures were the result of fraudulent accounting and other illegal practices, many of the same companies exhibited actual corporate governance risks such as conflicts of interest, inexperienced directors, overly lucrative compensation, or unequal share voting rights (Anderson and Orsagh, 2004). In the face of such scandals and malpractices, there has been a renewed emphasis on corporate governance.

Corporate governance covers a large number of distinct concepts and phenomenon as we can see from the definition adopted by Organization for Economic Cooperation and Development (OECD) – "*Corporate governance is the system by which business* *corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders and spells out the rules and procedures for making decisions in corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance*"[1]. From this definition we see that corporate governance includes the relationship of a company to its shareholders and to society; the promotion of fairness, transparency and accountability; reference to mechanisms that are used to "*govern*" managers and to ensure that the actions taken are consistent with the interests of key stakeholder groups. The key points of interest in corporate governance therefore include issues of transparency and accountability, the legal and regulatory environment, appropriate risk management measures, information flows and the responsibility of senior management and the board of directors. Many companies in the US have adopted legal compliance mechanisms which address ethics or conduct issues in formal documents (Weaver et al 1999), but much of this activity has been attributed to the 1991 U.S. Sentencing Commission's Guidelines for organizational defendants which prescribe more lenient sentences and fines to companies that have taken measures to prevent employee misconduct (Metzger et al, 1994 and Paine, 1994). From an ethical dimension, at a fundamental level, the key issues of corporate governance involve questions concerning relationships and building trust (both within and outside the organization).

Harshbarger and Holden (2004) point out that while many of the governance issues that organizations face are not new, the environment in which they confront them is more challenging than ever: State and Federal law enforcement have applied significantly increased resources and a more aggressive philosophy toward confrontation of governance lapses; the media spotlight has increased awareness among those constituents directly affected as well as the business community as a whole; shareholder proposals are taken more seriously; and the judiciary has demonstrated its willingness for a more stringent definition of good faith. As well, there are a number of factors that have brought ethical issues into sharper focus, including globalization, technology and rising competition. Van Beek and Solomon (2004) also note the ability to deliver a professional service will necessarily take place in an environment in which there is an increasing tendency towards individuality, while society as a whole becomes more global. The new realities of corporate governance show that no entity or agent is immune from fraudulent practices[2] and have altered the way companies operate; they have re-defined the baseline for what is considered prudent conduct for businesses and executives (Dandino, 2004).

2. Legal and Ethical Compliance Mechanisms

Legal Compliance Mechanisms

The difficulty with legal compliance mechanisms is that many abuses that have enraged the public are entirely legal, for example, companies can file misleading accounting statements that are in complete compliance with generally accepted accounting principles (GAAP). France et al (2002) point out that laws regulating companies are ambiguous, that juries have a hard time grasping abstract and sophisticated financial concepts (for example, special-purpose entities or complex derivatives), well-counseled executives have plenty of tricks for distancing themselves from responsibilities (Enron and the individual officers all deny they've broken any laws), and the fact that criminal law applies only to extreme cases so violations are hard to enforce. Based upon in-depth interviews with 30 graduates of Harvard MBA program, Badaracco and Webb (1995) revealed several disturbing patterns. First, young managers received explicit instructions from their middle-manager bosses or felt strong organizational pressures to do things that they believed were sleazy, unethical, or sometimes illegal. Second legal compliance mechanisms (corporate ethics programs, codes of conduct, mission statements, hot lines, and so on) provided little help in such environments. Third, many of the young managers believed that their company's executives were out-of-touch on ethical issues; either they were too busy or because they sought to avoid responsibility. Finally, the young managers resolve the dilemmas they faced largely on the basis of personal reflection and individual values, not through reliance on corporate credos or company loyalty.

Although the accounting profession has always had a strong focus on internal controls, recent spectacular business failures, which have undermined auditors' credibility in their reporting function, have eroded public confidence in the accounting and auditing profession. Brief et al (1997) found that 87% of accountants surveyed were willing to misrepresent financial statements in at least one case when presented with seven financial reporting dilemmas. This has led to new and more stringent applications of standards[3]. The problems of the professions (law, accounting, medicine) we are witnessing today are not endemic to the industry. They are part of the problems we are witnessing today in the wider society: sports, business, government and politics, education, and so on. Many of us, however, are concerned about the lack of ethics in the business world, particularly in the financial system, since there are greater incentives for unethical conduct. As a result of many scandals, there has been a renewed interest and focus on legal compliance mechanisms. For example, the Sarbanes-Oxley[4] law contains proposals that increase chief executive officers accountability for financial statements, increases penalty for fraud, makes chief executive officers and chief financial officers sign off financial statements, strengthens the role of the audit committee, and bans several types of non-audit consulting services by outside auditors. Auditors are required to give reports to audit committees on critical accounting policies and practices, information on alternative treatments of financial information, and bring to attention any material written communications with management (which could include disagreements as to the presentation of a company's accounts). The New York Stock Exchange and Nasdaq listing requirements purport to strengthen boards independence by requiring a majority of independent directors, requiring executive sessions, and tightening the definition of independence.

Ironically, Weisul and Merritt (2002) in surveying 1100 college students on 27 US campuses found that although the students were disturbed by recent corporate scandals (some 84% believed that the US is having a business crisis and 77% think CEOs should be held personally responsible for it), 59% of the same students admitted that they had cheated on a test and only 19% say they would report a classmate who cheated. Although a necessary component of corporate governance, legal compliance mechanisms have clearly proven to be inadequate; they lack the moral firepower to restore confidence and the ability to rebuild trust in the corporation. Termes (1995) compares ethical compliance mechanisms (virtues) versus legal compliance mechanisms (codes) and concludes that the ethical functioning of financial institutions cannot be trusted to the imposition of codes of ethical conduct but the only way in which companies can be ethical is for people to be ethical.

Ethical Compliance Mechanisms

Trevino et al (1999) study found that specific characteristics of legal compliance programs matter less than broader perceptions of the program's orientation toward values and ethical aspirations. They found that what helped the most are consistency between policies and actions as well as dimensions of the organization's ethical climate such as ethical leadership, fair treatment of employees, and open discussion of ethics. On the other hand, what hurts the most is an ethical culture that emphasizes self-interest and unquestioning obedience to authority, and the perception that legal compliance programs exist only to protect top management from blame. With respect to the issues of ethical leadership, Collins (2001) examined the character traits of effective business leaders in the culture of eleven companies that transformed themselves from good solid businesses into great companies that produced phenomenal and sustained returns for their stockholders. Every one of the companies he profiled during the critical period in which it was changing from good to great has what he termed "*Level 5*" leadership which was his top ranking for executive capabilities. Leaders in all companies exhibited the traits of fanatical drive and workmanlike diligence, but Level 5 leaders were also people of integrity and conscience who put the interest of their stockholder and their employees ahead of their own self-interest.

Byrne (2002) pointed out that following the abuses of recent times, executives are learning that trust, integrity, and fairness do matter and are crucial to the bottom line. Corporate leaders and entrepreneurs somehow forgot that business is all about values and are now paying the price in a downward market with a loss of investor confidence. Byrne (2002) also noted that in the post-Enron, post-bubble world, the realization that many companies played fast and loose with accounting rules and ethical standards and which allowed performance to be disconnected from meaningful corporate values, is leading to a re-evaluation of corporate goals, values and purpose. What's emerging is a new model of the corporation in which corporate cultures will change in a way that puts greater emphasis on integrity and trust. Such changes would include the diminishing of the single-minded focus on "shareholder value" which measures performance on the sole basis of stock price; the elevation of the interests of employees, customers, and their communities; a reassessment of executive pay to create a sense of fairness; a resetting of expectations so that investors are more realistic about the returns a company can legitimately and consistently achieve in highly competitive markets.

There is little doubt that corporate culture contributed to and is at the heart of the recent scandals and transgressions. Hansen (2004) doubts whether legal compliance mechanisms alone can show the way to business probity and points out the need to ask some basic questions: Are Sarbanes-Oxley and the mandated reforms being made likely to achieve the desired goal? Will our efforts foster a more ethical business environment or is it likely that much of the effort will be directed to formulaic conformity with the appearance of ethical probity? Will corporations be prompted merely to offer empty clichés in their public embrace of integrity (e.g. some corporations might think that rewriting their value statement in a larger font size might somehow translate into a more impassioned ethical commitment)? Hansen (2004) also points out that more explicit recognition of the role of culture in an organization may be forthcoming since the challenge is to ascertain whether a corporation's compliance program is merely a "*paper program"* or whether it was designed and implemented in an effective manner. A cultural norm that reinforces the importance of compliance is one measure of a real compliance program as opposed to one that merely exists on paper (e.g. Does the company treat employees fairly? Is it honest in its business dealings? etc.)

At the core of the current debate over corporate governance is the issue whether managers of corporations should serve the interests of shareholders or the interests of all stakeholders (employees, creditors, suppliers, customers, community, shareholders). This issue is related to a more fundamental question of the nature and purpose of the firm (is it an entity, an aggregate of individuals, a nexus of private contracts?). Two essentially different models of corporate governance can be identified: the model based on the maximization of shareholder value and the model of social responsibility[5]. Ambrosio and Toth (1998), using a natural ethical framework, show that the latter is more coherent with human nature as the natural law perspective posits the primacy of ethics over politics, law and economics. Economics cannot be divorced from ethics anymore than law, politics, education can (Arjoon and Gopaul, 2003). Natural law ethical theory provides a framework to address the moral dimension of human action, serves as a guide to those directly responsible for corporate governance, judges whether particular corporate actions are consistent with legal obligations, and provides the grounds for a moral critique of existing laws and practices related to corporate governance. The shareholder wealth maximization model deflects attention from the ethical questions and the concern for values. Related to the first principle of natural law ethics (do good and avoid evil) is virtue ethics (be virtuous and avoid vices), which provides more positive principles for the practice of corporate governance.

Legal vs. Ethical Compliance Mechanisms

Kleining (1999) observes that despite certain congruities and convergences, there are some very important differences in the character and content of ethical and legal requirements which can help us understand why ethics is accorded a normative primacy in practical affairs and legality is to be judged by reference to ethics (not vice versa). Specifically, law is concerned primarily with conduct and ethical requirements are centrally concerned with reasons, motives, intentions, and more generally with the character that expresses itself in conduct. Ethics therefore is concerned with what we are and not just what we do. Also, law is jurisdictionally limited since what is legitimately required in one state or country may differ from another, whereas ethical values are inclined to be more universal. Kidder (1995) defines ethics as "*obedience to the unenforceable*". Longstaff (1986) argues that an overemphasis on legal compliance mechanisms[6] could be at the expense of ethical reflection since people may have less reason to form their own opinions and take personal responsibility for the decisions they make. This could result in a subtle substitution of "*accountability*" for "*responsibility*". Table 1 shows the differences between the legal compliance and the ethical compliance approaches.

Table 1
Differences in Legal and Ethical Compliance Approaches*

Factors	Legal	Ethical
Ethos	Regards ethics as a set of limits and something that has to be done	Defines ethics as a set of principles to guide choices
Objectives	Geared toward preventing unlawful conduct	Geared toward achieving responsible conduct
Method	Emphasizes rules and uses increased monitoring and penalties to enforce these rules	Treats ethics as infused in business practice (leadership, core systems, decision-making processes, etc)
Behavioral Assumptions	Rooted in deterrence theory (how to prevent people from doing bad things by manipulating the costs of misconduct)	Rooted in individual and communal values (both material and spiritual)

*Adapted from Paine (1996)

The current business environment provides an excellent opportunity to establish an organizational culture that goes beyond mere legal compliance[7]. Harshbarger and Holden (2004) also agree that as the new realities of corporate governance set in, the substance of the new laws and rules must not be lost in the race to comply with their form. They point out that organizations must make a good faith effort to comply not just with the letter of the law, but with the spirit of the new reforms that recognizes three primary benefits: (1) provides organizations with a stronger measure of an inexpensive insurance mechanism and is a strong mitigating factor in any sanction imposed, (2) more accurate information flows to the top enabling more efficient and effective business decisions, and (3) the imprecise reforms offer business leaders the opportunity to emerge with more well defined standards (leaders should be embracing this period of reform as an opportunity to institutionalize their systems).

Legal compliance mechanisms tend to promote a *freedom of indifference* which corresponds to the *letter of the law* which may not necessarily inspire or instill excellence, whereas, ethical compliance mechanisms promote a *freedom for excellence* which corresponds to the *spirit of the law* (see Table 2). The former concept of freedom is more seen as an external limit imposed on the agent while the latter governs the dynamism and development of a person's faculties of action and tends toward perfection or happiness of the human person. These concepts of freedom explain why legal compliance mechanisms are insufficient and may not be addressing the real and fundamental issues that inspire ethical behavior. They also provide the theoretical basis for explaining the different moral or ethical behavior that arises from the legal and ethical compliance approaches that is presented in Table 1.

Table 1
Two Forms of Freedom*

Freedom of Indifference	Freedom for Excellence
Ability to choose between contraries	Ability to act with excellence and perfection whenever one wishes
Precedes and dominates every natural inclination. Proceeds from the will alone in its "*indifferenced*" to contraries	Proceeds from reason and will and from the natural longing for truth, goodness, and happiness
Entirely present from the beginning	Develops gradually through education
Each free act is independently governed by obedience to the law	Unites one's actions in an ordered whole through a finality (happiness) that ties them together interiorly
Virtue is a habit of submission to law	Virtue is to act with professional excellence
Legal compliance is external to freedom, which it limits through obligation. It is the work of the will of the legislator	Legal compliance is seen to have an educational role in the growth of freedom. It is a work of wisdom and corresponds to one's most intimate longings
Engenders legal compliance and obligation. The question of happiness is extrinsic	Engenders an ethics of happiness and virtue, which springs from one's interior inclinations

* Adapted from Pinckaers (2001, pp 74).

Pinckaers (2001) points out that these two distinct conceptions of freedom engender two types of morality: freedom of indifference is the source of moralities of obligation and freedom for excellence inspires moralities of happiness and virtue. Under freedom of indifference one loses sight or is no longer concerned for the bigger picture (the common good or happiness) that would unite all acts in one same intention since each act is viewed as independently governed by obedience to the law. It reduces ethical behavior to cases of conscience (the act of judgment) and presupposes a freedom that can be limited only in its external expression. In this case, virtue loses its formative role and simply becomes a habit of submission to the law. Freedom for excellence, on the other hand, engenders a morality that regards happiness as decisive for the integral ordering of one's life and the formation of one's character. Central to this, are the cardinal virtues which strengthen freedom and refine human actions. Freedom for excellence can be compared with an acquired skill in an art or profession as it is the capacity to produce our acts when and how we wish, like high-quality works that are perfect in their domain. Pinckaers (1995) provide comprehensive discussion of these two concepts of freedom.

Paine (1996) identified an organizational integrity-based stratagem that is more comprehensive and broader than the legal compliance strategy to encourage and support an ethical corporate culture. Four challenges which must be met before an organizational integrity approach can work: (1) developing an ethical framework, (2) aligning practice with principles, (3) overcoming cynicism, and (4) resolving ethical conflicts. In order to create an ethical compass or a framework for integrity, Paine (1994) also suggests a useful starting point is to begin by answering some questions to the four fundamental sources of responsibility: (1) What is the organization's fundamental reason for being –

its ultimate aim (*purpose*)? (2) Who are the constituencies to whom the company is accountable and on whom it depends for success? What are their legitimate claims and interests (*people*)? (3) What is the organization's authority and ability to act (*power*)? and (4) What are the organization's obligations or duties, as well as its guiding aspirations and ideals (*principle*)?

3. The Role of Virtues

If organizations concentrate on acquiring those virtues which are most useful in the business world, then it will have made great material progress since it attempts to improve employees who, in turn, help the institution to be more profitable. Virtues are traits of character that make a person a happy person, a company a productive and profitable one, a nation a great and fine nation. Virtues are acquired by habituation or repetitive practice. Sporadic bursts of effort do not lead to the attainment of virtue; virtue is attained through continuity of effort, the constancy of trying each day. People who habitually act well continue to do so even when they are confronted with difficulties since virtues sustain them. For example, if one lives the "*heroic minute*" when one awakes in the morning, thereby overcoming laziness from the very first moment of the day, one will find it easier to be diligent in going about one's other duties whether they be large or small. The business of success (both personal and professional) is based upon the increase in virtue.

Virtues are good habits that are acquired by repetition which must follow the rule of right reason (prudence). For example, for a person to acquire the virtue of self-mastery, he or she must follow the rules laid down by right reason for the proper use of, for example, food, drink or sex, for the preservation of oneself and the human species. To be virtuous, we must acquire the habit of choosing to act well (that is, we must have a firm and settled disposition to chose good) in a variety of contexts (each different context defines a different virtue). The moral virtues also work according to what Aristotle called the "*golden mean*" of human reason, which is the middle path that reason indicates between two other paths that lead to excess or deficit (this "*middle*" or "*mesortes*" is the summit or peak between the two extremes or vices). Under a virtue-ethics framework, right actions are defined in terms of a mean or intermediate between two extremes or vices. Apart from the virtue of justice, every moral virtue has these two opposites: courage (cowardice – foolhardy), generosity (stinginess – extravagance), humility (vanity – pride), and so on. The acquisition or development of virtues can be compared to that of becoming a good athlete: performance is habitual or consistent, superior performance depends upon the ability to avoid too much or too little, and no one reaches the highest level of athletic performance without intensive practice. Leaders and those responsible for others play a significant role in the development or erosion of virtue in employees and other persons. Crisp and Slote (1998), MacIntyre (1984), and Statman (1997) provide excellent and comprehensive discussions on virtue ethics.

There are fundamental virtues that are essential for any (ethical) decision-making agent. These are the four cardinal virtues (from the Latin *"cardo"* which means hinge): prudence, justice, courage, and self-mastery. These four virtues are the principal natural or moral virtues which coordinate human activity and direct it to the good or fulfillment of a person. The cardinal virtues are the roots from which all other human virtues grow because the former perfects all a person's natural powers in their functions in pursuit of good.

Prudence (also called wisdom, good judgment, competence, practical reasoning) is the habit of recognizing good ends and choosing the most effective and efficient means of achieving them. The wise or prudent professional knows what is worth pursuing and chooses the good (legitimate) means. The imprudent person may see what the goals should be but he or she cannot consistently find a good way of accomplishing these goals. There is a notion or vice of what can be termed a "*false prudence*" which leads people to seek only what is useful to their own material well-being; examples of these are deceit, hypocrisy, and self-interested calculation. Prudence is the most important among the cardinal virtues since it is necessary in order to practice the others. Prudence can be equated to good judgment and right reasoning about people and action. The prudent manager has a grasp of the complexity of the business environment and instantiates the other virtues in a concrete situation. For example, an investment portfolio manager needs to offer opportunities of placing funds in financial instruments with appropriate risk. Going too fast means concentrating excessive risk or abusing one's power (managers are not paid to take risk, they are paid to know which risks are worth taking)[8]. In the corporate world, prudence is the virtue necessary to select the most appropriate and effective means to attain the desired outcomes through making the "*right calls*". Prudence in business is fostered by developing a great familiarity, beyond mere intellectual comprehension, with the different elements of business decisions which must be known not only in their principles, but also in their concrete aspects. Gomez (1992) points out that prudence requires an optimization of the past (studying precedents, weighing previous experience, consultation, retaining what is positive and rejecting what is negative), diagnosis of the present (eye for details, circumspection, understanding of the present, capacity to draw conclusions), and foreseeing the future (reducing risk).

Justice (commonly referred to as fairness) describes a situation or a habit in which one constantly gives others what is their due so they can fulfill their duties and exercise their rights, and at the same time, one tries to see that others do likewise. For instance, the market requires justice in exchange (for example, the payment of a just wage which ought not to be solely determined by the market) and it is a criterion under which we can judge the whole socio-economic system. Justice does not lead us to jump to conclusions or form hasty judgments of others. To live justice is to respect another person's privacy which we need to protect from the curious gaze of outsiders and not divulge in public what ought to remain within the domain of the organization. Many injustices are committed by pronouncing irresponsible judgments; every person and institution has a right to a good name. Calumny, slander, malicious gossip constitute serious unjust assaults against persons and organizations.

Courage (formerly referred to as fortitude) is the habit moderating the emotions of fear or boldness to achieve a rational goal. It is the ability to face and to overcome difficult situations and the power to act even when we are afraid. In a business situation, courage may be required to enable a person to overcome fear consistently and stand up for the rights of others, to venture unpopular criticisms, to relocate incompetent employees, to proceed in difficult downsizing or rightsizing exercises, to participate in politically charged labor-management negotiations, or to take action in worthwhile projects in spite of the risks involved. The courageous person should be contrasted with both the cowardly and the foolhardy or reckless. Cowardly persons exaggerate the risk or danger of a situation. Foolhardy persons may be insensitive to the risks and dangers, and also suffer from the consequences. Being courageous does not mean that person might never retreat from danger or never assume a risk, but rather that this person's judgment about such situations is consistently sound. It leads one to be patient when unpleasant things happen or in dealing with obstacles, to overcome own whims, selfishness, laziness to face up to the normal obstacles of everyday life, to bear sickness patiently, and to avoid outer display of bitterness, bad temper, gloominess.

Self-mastery (also known as temperance or discipline) is the ability to have control over our tendencies to laziness, anger, complacency, procrastination, and reluctance to fulfill our responsibility. It can be defined as the virtue of moderating the disordered emotions of enjoyment. It is required in business, for example, to overcome pressures to play favorites, to be excessively frugal, or to waste money on luxuries. Self-mastery is also necessary to make good judgments about the allocation of scarce resources.

The human or moral virtues are all related and form a "*single tapestry*". Piper (1966, pp8) describes prudence as the cause, root, mother, measure, precept, guide, and prototype of all ethical virtue. Injustice, cowardice and intemperance run counter to prudence. We cannot be prudent if we don't have the other virtues. If someone always acts cowardly, he or she cannot be a prudent person. On the other hand, if someone is imprudent, then he or she may not be able to make proper decisions that are based on the virtues of courage or justice. There is an interdependent relationship among the cardinal virtues. Moreso, all other moral virtues hinge on these four fundamental virtues: prudence (*hinged to* understanding, docility, shrewdness, etc), justice (*hinged to* order, truthfulness, loyalty, mercy, etc), temperance (*hinged to* sobriety, continence, abstinence, modesty, etc) and courage (*hinged to* patience, perseverance, constancy, etc). Because of the interconnectedness of the virtues, growth in one reflects a growth in all, while a fall in one results in a decrease in the virtuous life. Piper (1966) perhaps provides one of the most lucid explanations of the cardinal virtues. Some graphical points of reflection or examination on the cardinal virtues from Saint Josemaría Escrivá[9], who was an outstanding exemplar of the virtues, are provided in the Appendix.

4. Conclusion

Failure in corporate governance is a real threat to the future of every corporation. With effective corporate governance based on core values of integrity and trust (reputational value)[10] companies will have competitive advantage in attracting and retaining talent and generating positive reactions in the marketplace – if you have a reputation for ethical behavior in today's marketplace it engenders not only customer loyalty but employee loyalty. Effective corporate governance can be achieved by adopting a set of principles and best practices. A great deal depends upon fairness, honesty, integrity and the manner in which companies conduct their affairs. Companies must make a profit in order to survive and grow, however, the pursuit of profits must stay within ethical bounds. Companies should adopt policies that include environmental protection, whistle blowing, ethical training programs and so on. Such compliance mechanisms help develop and build corporate image and reputation, gain loyalty and trust from consumers and heightens commitment to employees. Ethical compliance mechanisms contribute to stability and growth since it instills confidence; management, leadership, and administration are essentially ethical tasks. The focus of the virtues in governance is to establish a series of practical responses which depend on the consistent application of core values and principles as well as commitment to ethical business practice. Virtues are powerful means to personal betterment and bring about social reform Because of its strong appeal to reason, it diffuses passion, prejudice, pride and self-interest and is a civilizing force in bringing about justice.

Ethics is truly an essential ingredient for business success and it will continue to serve as the blueprint for success in the 21st century. Many of our traditional role models have fallen, and so it is more important for us to set a strong ethical example for future generations. Some answers to the following questions can serve as a basis for future research endeavors. Were the recent scandals in the US and elsewhere the result of corporate greed and collusion, or were companies driven by market forces which they were unable or unwilling to resist? Do we need a radical overhaul of corporate governance and codes or can companies be relied upon to regulate themselves? Are businesses collectively contributing to the problems, albeit unwittingly or through ignorance? Do the solutions lie outside liberal capitalism?

Perhaps it is most appropriate to close by the following remark which succinctly captures the aspects of corporate governance as discussed in this paper:

"*An adequate corporate strategy must include noneconomic goals ... An economic strategy is humanized and made attainable in a living organization by deciding on the character the company is to have, the values it espouses, and its relationships to its customers, employees, communities, and shareholders. The personal values and ethical aspirations of the company leaders, though probably not specifically stated,* *are implicit in all strategic decisions … Although codes of ethics, ethical policy for specific vulnerabilities, and disciplined enforcement are important, they do not contain in themselves the final emotional power of commitment. Commitment to quality objectives – among them compliance with law and high ethical standards – is an organizational achievement. . It is inspired by pride more than the profit that rightful pride produces. Once the scope of strategic decision is thus enlarged, its ethical component is no longer at odds with a decision right for many reasons*".

Kenneth Andrews (1989, pp 10/11)

Endnotes

[1] OECD April 1999. Please see **http://www.encycogov.com/WhatIsGorpGov.asp**.

[2] Marshall Cogan (the founder, controlling shareholder, CEO and Chairman of the Board of Directors of Trace Holdings International) over a period of 15 years, took some $40m from the company through a number of self-dealing transactions while the officers and directors stood by idly. Trace ultimately entered into a Chapter 7 bankruptcy proceeding and the trustee subsequently filed a suit against Cogan and the Trace officers and directors. The court held for the trustee, citing the directors' utter failure to exercise their legal duties to act on behalf of Trace's shareholder and creditors, and went so far as to impose liability on Trace officers who were not part of the board, but who had the authority to preempt Cogan's misappropriations (Dandino, 2004). Martha Stewart was also recently convicted and was found guilty of conspiracy, making false statements and obstruction of justice. Her ex-stockbroker, Peter Bacanovic was also convicted of similar charges.

[3] In January 2003, AIMR and its Disciplinary Review Committee sent a letter to all AIMR members reminding them of their obligations under the Code and Standards requesting, *"If you become aware of unethical conduct by a fellow member, please let us know. If you are unsure about the membership status of an investment profession, file a complaint and we will make that determination … we cannot act without knowledge of a violation and we cannot act against those who are not AIMR members. You can help us*

acquire that knowledge, and we encourage you to take a more active interest in ensuring that AIMR members abide by the Code and Standards (www.aimr.org).”

[4] The Sarbanes-Oxley Act of 2002 (signed into law on July 30), the most radical reform of corporate governance since the Great Depression of the 1930s, has a number of major ramifications on large businesses: banning loans to directors and officers; disgorging compensation already paid to CEOs and CFOs in cases of financial misconduct; directing CEOs and CFOs to personally certify their familiarity with reports, legal compliance, material accuracy, and disclosures to the public and to the audit committee; requiring the audit committee to preapprove outside auditors, avoid some non-audit services such as consulting, rotate the responsible partner reporting directly to the audit committee, and avoid conflicts and coercion, requiring the audit committee to have sole authority over auditors, consist of only non management directors, establish protections for whistle-blowers, and disclose the identity of financial experts on the committee and board; calling for attorneys to report violations by their corporate clients and, if there is no action, to report violations to the SEC directly. It also calls for additional or accelerated SEC filings, reviews, and disclosures; corporate disclosure of a code of ethics governing conduct of management and financial personnel; and extensively increased SEC enforcement and penalties (Jacobs, 2004).

[5] In practice, many firms adopt the model of social responsibility. There is a push for what is called “The Triple Bottom Line” model of the firm – economic, social, and environmental – which has been gaining recognition in the business community due to pressure of the recent scandals. This effort has been pioneered by the Global Reporting Initiative (GRI – **www.globalreporting.org**).

[6] The Economist (2004, pp 15) observed that many people are concerned about the proliferation of new business regulations used to prevent recurrence of business scandal, but over-regulation may not be the right answer. A recent study by a World Bank team (The Economist, 2004 pp 16) revealed also that the poorest countries have the most rules which make returns from entrepreneurial risk-taking unattractive and provides an avenue for corruption. The same study also concluded that over-regulation can scare away foreign capital.

[7] A speech given by Commissioner Cynthia Glassman on Sarbanes-Oxley's lesson for Broker Dealers, October 17, 2003, captures this aspect: "*As we move past Sarbanes-Oxley and the requirements, rules and regulations that have come in its wake, it's essential that corporate boards look beyond the letter of the law and be ever mindful of the spirit of the reforms. By determining what makes up the moral DNA of the company and establishing a culture that puts ethics and accountability first, a company and its Board are less likely to fall into the common trap of mere compliance – where simply identifying a new line of legally acceptable behavior and how to maneuver the loopholes that accompany it passes for a commitment to reform*".

[8] An article entitled "The Price of Prudence" (The Economist, 2004, pp 6)" warned that governments must protect their citizens, but not at any costs. For example, in 1994, Mc Donald's was required to pay $3 million (later reduced) to settle a lawsuit after a customer spilled a cup of its scalding hot coffee on her lap. Now the firm is being sued for allegedly making people fat. A subtle substitute of "accountability" for "responsibility", or what Philip Howard, an American author, has called "*the death of common sense*".

[9] Saint Josemaría Escrivá was born in Barbastro, Spain, on a January 1902. He was ordained to the priesthood in Saragossa on 28 March 1925. On 2 October 1928, by divine inspiration, he founded Opus Dei. On 26 June 1975, he died unexpectedly in Rome in the room where he worked, after a last affectionate glance at a picture of Our Lady. Opus Dei had by then spread to five continents, with over 60,000 members of 80 nationalities, serving the Church with the same spirit of complete union with the Pope and the Bishops which characterized Saint Josemaría. His Holiness Pope John Paul II canonized the Founder of Opus Dei in Rome on 6 October 2002. His feast is celebrated on 26 June. The body of Saint Josemaría rests in the prelatic Church of Our Lady of Peace, Viale Bruno Buozz 75, Rome. Further information on his life and works can be found at **www.escrivaworks.org**.

[10] A survey of 2000 public and private companies, conducted by Aon, an American insurance company, found that the single biggest risk or business hazard was *reputational risk* (The Economist, 2004, pp 14).

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Appendix

Saint Josemaría Escrivá on the Cardinal Virtues

Saint Josemaría Escrivá was an *outstanding* exemplar of the virtues. Known as "*the saint of ordinary things*", his key message was that ordinary men and women ought to convert their everyday work, their family life, their social relationships, and the whole of their lives into a way of serving God, the Church and others (a unity of one's life of faith and one's temporal life) while spreading the joyful message that God calls everyone to holiness – *sanctity is for everyone*. He also practiced what he preached and wrote about. Among his outstanding character traits, Saint Josemaría Escrivá was known for his outstanding capacity for organization and governance (de Prada, 2002, pp 361). Arguably the most widely read spiritual writer of the last century, the following points of reflection or examination on the cardinal virtues are taken from three of his works (Escrivá 1982, 1986, 1988) which graphically illustrates ethical compliance mechanisms, in particular, the applications of the cardinal virtues.

Prudence

When you are told what to do, let no one show more alacrity than you in obeying; whether it is hot or cold, whether you feel keen or are tired, whether you are young or less so, it makes no odds. Someone who "does not know how to obey" will never learn to command. *The Forge (627)*

Authority. This does not consist in the one above *yelling* at the one below, and he in turn to the one further down. In such a way of behaving – a caricature of authority – apart from an evident lack of charity and of decent human standards, all that is achieved is that the one at the top becomes isolated from those who are governed, because he does not serve them: rather could it be said that he uses them. *Furrow (386)*

Occupying as you do a post of government, I say, “Mediate on this: the strongest and most effective instruments, if they are not properly used, become dented, worn out and useless.” *Furrow (391)*

I think it is very good that you should try daily to increase the depth of your concern for those under you, for to feel surrounded and protected by the affectionate understanding of the one in charge can be the effective help which is needed by the people you have to serve by means of your governance. *Furrow (395)*

How sad it is to see some people in positions of authority speaking and making judgments lightly, without studying the matter in hand. They make hard statements about persons or matters they know nothing about, even permitting certain *prejudices* which are the result of disloyalty! *Furrow (396)*

If authority becomes dictatorial authoritarianism, and this situation is extended in time, historical continuity is lost. People without experience in government reach the top and the inexperienced and excitable young want to grab hold of the reins. How many evils and how many offences against God – their own and those of others – are to be blamed on the ones who abuse authority so badly! *Furrow (397)*

Try to be properly objective in your work of governance. Avoid the inclinations common to those who tend to see rather – and sometimes only – what is not going well, the mistakes. Be filled with joy and be assured that the Lord has granted to all the capacity to become holy precisely by fighting against their own defects.

Furrow (399)

Eagerness for novelty can lead to mismanagement. You say we need new rules. But do you think the human body would be better with a different system of nerves and arteries? *Furrow (400)*

Never put your trust in organization alone. *Furrow (403)*

Good governance knows how to be flexible when necessary, without falling into the mistake of not asking enough of people. *Furrow (406)*

Having a position of high authority, you would be imprudent to interpret the silence of those who listen to you as a sign of acquiescence. Ask yourself whether you allow them to make suggestions, or whether you take offence if they actually let you know what they think. You must change your ways. *Furrow (919)*

There is no prudence in appointing untried men to important posts of direction just to see how it works out. It would be like risking the common good on a lucky dip. *Furrow (969)*

You must be quite foolish to go by what people say when you have been given a position of authority. First of all you should worry about what God will say; then, very much in the second place, and sometimes not at all, you may consider what others think. “Whoever acknowledges me before men”, say the Lord, “I too will acknowledge him before my Father who is in heaven. But whoever disowns me before men, I will disown him before my Father who is in heaven.” *Furrow (970)*

Never say of anybody under you: he is no good. It is you who are no good, for you cannot find a place where he will be of use. *Furrow (975)*

Justice

There is a great love of comfort, and at times a great irresponsibility, hidden behind the attitude of those in authority who flee from the sorrow of correcting, making the excuse that they want to avoid the suffering of others. They may perhaps save themselves some discomfort in this life. But they are gambling with eternal happiness – the eternal happiness of others as well as their own – by these omissions of theirs. These omissions are real sins. *The Forge (577)*

Don’t be one of those who let their own homes be badly managed but attempt to meddle in the management of other people’s. *Furrow (387)*

The good shepherd does not need to terrorize the sheep. Such behavior befits bad rulers, and no one is very much surprised if they end up hated and alone. *Furrow (404)*

Positions. Who’s in, who’s out? What does it matter to you? You have come, you tell me, to be useful, to serve, with complete availability. Behave accordingly. *Furrow (705)*

Don't' get annoyed. Irresponsible behaviour often denotes poor formation or a lack of intelligence, rather than want of good spirit. Teachers and directors should be expected to fill in those gaps with the responsible fulfillment of their duties. You should examine yourself if you are in such a position.

Furrow (951)

Mediocre men, mediocre in mind and in Christian spirit, surround themselves by stupid people when they are in power. They are falsely persuaded by their vanity that in this way they will never lose control. Sensible men, however, surround themselves with learned people who live a clean life as well as possessing knowledge, and become, through their help, men who can really govern. *Furrow (968)*

If you occupy a position of responsibility you should remember as you do your job that personal achievement perishes with the person who made himself indispensable. *Furrow (971)*

A fundamental rule for good management is to give responsibility to others without this becoming for you a way of seeking anonymity or comfort. I repeat, delegate responsibility and ask each person to give an account of how his job is going, so that you can "render an account" to God; and to souls, if necessary.

Furrow (973)

When you are dealing with problems, try not to exaggerate justice to the point of forgetting charity.

Furrow (973)

Never reprimand anyone while you feel provoked over a fault that has been committed. Wait until the next day, or even longer. Then make your remonstrance calmly and with a purified intention. You'll gain more with an affectionate word than you ever would from three hours of quarrelling. Control your temper.

The Way (10)

That critical spirit – granted you mean well – should never be directed toward the apostolate in which you work nor toward your brothers. In your supernatural undertakings that critical spirit – forgive me for saying it – can do a lot of harm. For when you get involved in judging the work of others, you are not doing anything constructive. Really you have no right to judge, even if you have the highest possible motives, as I admit. And with your negative attitude you hold up the progress of others. "Then," you ask worriedly, "my critical spirit, which is the keynote of my character…?" Listen I'll set your mind at ease. Take pen and paper. Write down simply and confidently – yes, and briefly – what is worrying you. Give the note to your superior, and don't think any more about it. He is in charge and has the grace of state. He will file the note…or will throw it in the wastebasket. And since your criticism is not gossip and you do it for the highest motives, it's all the same to you. *The Way (53)*

Your very inexperience leads you to presumption, vanity and to all that you imagine gives you an air of importance. Correct yourself, please! Foolish and all, you may come to occupy a post of responsibility (it's happened more than once), and if you're not convinced of your lack of ability, you will refuse to listen to those who have the gift of counsel. And it's frightening to think of the harm your mismanagement will do.

The Way (352)

When you see people of doubtful professional reputation acting as leaders at public activities of a religious nature, don't you feel the urge to whisper in their ears: "Please would you mind being just a little less Catholic!" *The Way (371)*

If you have an official position, you have certain right and also certain duties which go with it. You stray from your apostolic way if the occasion – or the excuse – of a work of zeal makes you leave the duties of your office unfulfilled. For you will lose your professional prestige, which is exactly your "bait" as a fisher of men. *The Way (372)*

If they see you weaken – you, the leader – it is no wonder their obedience wavers. *The Way (383)*

Let's not confuse the rights of the office with personal rights. The former can never be renounced.

The Way (407)

Many false apostles, in spite of themselves, do good to the masses, to the people, through the very power of the doctrine of Jesus which they preach – even though they don't practise it. But this good does not compensate for the enormous and very real harm they do by killing the souls of leaders, of apostles, who turn away in disgust from those who don't practise what they preach. That's why such men and women, if they are not willing to live an upright life, should never push themselves forward as leaders. *The Way (411)*

To punish for the sake of Love: this is the secret that raises to a supernatural plane any punishment imposed on those who deserve it. For the love of God, who has been offended, let punishment serve as atonement. For the love of our neighbor, for the sake of God, may punishment never be revenge, but a healing medicine. *The Way (424)*

Charity consists not so much in giving as in understanding. That's why you should seek an excuse for you neighbor – there are always excuses – if yours is the duty to judge. *The Way (463)*

Who are you to judge the rightness of a superior's decision? Don't you see that he has more basis for judging than you? He has more experience; he has more upright, experienced and impartial advisers; and above all, he has more grace, a special grace, the grace of his state, which is the light and the powerful aid of God. *The Way (457)*

What a pity if the one in charge doesn't give you a good example! But is it only for his personal qualities that you obey? Or do you in your selfishness interpret St Paul's "*obedite praepositis vestris*" – "Obey, your superiors" with an addition of your own: "Always provided they have virtues to my own taste?"

The Way (621)

Courage

It is not pride, but fortitude, when you make your authority felt, cutting out what needs to be cut out, when the fulfillment of the Holy Will of God demands it. *The Forge (884)*

In governing, after considering the common good, one must realize that both in spiritual and in civil affairs it will be very rare for a law to displease nobody. There is a popular saying: The rain never pleases everybody. Yet you can be sure that is not a defect of the law, but an unjustified rebelliousness of pride and selfishness by a few. *Furrow (385)*

Governing often consists in knowing how, with patience and affection, to *draw good* out of people.

Furrow (405)

I felt pity for that man in office. He suspected that there might have been some problems, which are, after all, to be expected in life, yet he was taken aback and annoyed when he was told about them. He preferred to remain ignorant of them, to live in the shadow or twilight of his own vision, so that he might remain at ease. I advised him to face up to these things openly and clearly, so that in this very way they could be got rid of. I assured him that then he would truly live in peace. You must not solve problems, your own or those of others, by ignoring them; this would be nothing short of laziness and comfort-seeking, which would open the door to the action of the devil. *Furrow (581)*

If someone thought that wolves could be reared among sheep, imagine what chance the sheep would have.

Furrow (967)

Don't let the lack of "instruments" stop your work. Begin as well as you can. As time passes, the function will create the organ. Some instruments formerly worthless, will become suitable. The rest can undergo a surgical operation, even though it be painful (there were no better "surgeons" than the saints!) and the work will go on. *The Way (488)*

Self-mastery

When you have to give orders, do not humiliate anyone. Go gently. Respect the intelligence and the will of the one who is obeying. *The Forge (727)*

Hands must sometimes be tied, with respect and with temperateness, without insult or discourtesy. Not out of revenge, but as a remedy; not as a punishment, but as a medicine. *The Forge (885)*

But do you really think you know it all just because you have been placed in authority? Listen carefully: the good ruler *knows* that he can, that he *should*, learn from others. *Furrow (388)*

Decisions of governance taken lightly or by someone on his own are always, or nearly always, influenced by a one-sided view of the problems. However good your training or talents might be, you must listen to those who share with you that task of direction. *Furrow (392)*

People have to be taught how to work, but their preparation need not be overdone, for actually doing things is a way of learning too. They should accept in advance their unavoidable shortcomings – the best is the enemy of the good. *Furrow (402)*

Reject any ambition for honours. Think instead about your duties, how to do them well and the instruments you need to accomplish them. In this way, you will not hanker for positions, and if one comes you will see it just as it is: a burden to bear in the service of souls. *Furrow (976)*