

# Corporate Governance and Global Responsibility

*Daniela M. Salvioni\**

## *Abstract*

*The application of proper governance principles demands a clear focus on sustainable growth as the basis for risk minimization in order to ensure long-term company success. In other words, a company's effectiveness implies the assumption of a global responsibility concept based on strict compliance with the law, the creation of constructive relationships with all of society and respect for the environment.*

*Of course, this does not mean losing sight of the importance of creating value and adequately compensating risk capital providers. Instead, it means emphasizing the interdependence of corporate image, results (whether financial or otherwise), operating transparency and the obtaining of broad approval and resources.*

**Keywords:** Corporate Governance; Sustainable Growth; Internal Control; Stakeholder Relation

## **1. Corporate Responsibility and Business Principles**

The affirmation of corporate socio-economic values is innate in Italian business management studies. Close interdependence between economic aspects and the social role has always been considered at the theoretical level. For example, Gino Zappa wrote in his first volume on 'Production' (1956): '*... for long-term success, a company must discharge numerous responsibilities not only with regard to its employees, but also to society at large. A company must balance its corporate self-interest with the interests of those who willingly work for it, and must submit to demands deriving from the common good of the society in which it operates*'<sup>1</sup>.

Although the above quote must be considered in its historical and economic context, it clearly demonstrates that the founding fathers of modern Italian business management based their corporate governance theories on a wide-ranging concept of corporate responsibility.

The consideration of legal/administrative, financial, social and environmental responsibilities is not new for business managers. From the very beginning, theoretical treatises have emphasized the socio-economic context for corporate

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\* Full Professor of Business Administration, University of Brescia ([salvioni@eco.unibs.it](mailto:salvioni@eco.unibs.it))

operations, while not denying the primary aim of creating wealth for the short-term and long-term benefit of risk capital providers. This context stresses the need to develop a company in relation to the common good of interested parties in conformity to the requisites of justice, equity and fairness.

Nevertheless, economic system evolution has witnessed the progressive separation of theoretical views and behavioural practices. Corporate choices have often favoured shareholder expectations, frequently driven by profit and at times even tending to exhibit unequal treatment amongst risk capital provider subgroups (for example, between majority and minority shareholders).

A new concept of the corporation's role in society has only recently taken root around the world. This follows the proliferation of cases involving manifest fraud or misconduct (for example, Enron, WorldCom, Merck, Vivendi, Cirio, Parmalat, etc.). Shareholder interest is being reassessed, as is the interdependence of respect for the law, economic-social-environmental behaviour and the potential to acquire consensus and resources<sup>2</sup>. This leads to a re-thinking of governance orientation, the interaction between governance and management organs, and a profound review of the variables crucial to optimise performance.

The application of proper governance principles demands a clear focus on sustainable growth as the basis for risk minimization in order to ensure long-term company success. In other words, a company's effectiveness implies the assumption of a global responsibility concept based on strict compliance with the law, the creation of constructive relationships with all of society and respect for the environment. Of course, this does not mean losing sight of the importance of creating value and adequately compensating risk capital providers. Instead, it means emphasizing the interdependence of corporate image, results (whether financial or otherwise), operating transparency and the obtaining of broad approval and resources.

## **2. The Development of Governance**

Increasingly complex corporate systems, market globalisation and the awareness of at-times unethical attitudes are making it increasingly necessary to restore a multi-dimensional vision. Such a vision emphasizes the importance of the quality of relations between a company and its stakeholders in full compliance with laws and with respect for the ecosystem. In this context, the following have taken on increased significance:

- changes to regulations and codes of conduct aimed at controlling governance authorities and policies;
- the need to promote a culture based on the principles of equity and fairness;
- an emphasis on connecting the expectations of all parties in society and the decisions and actions that jointly define corporate development;
- the adoption of policies aimed at prudent risk management;
- reapplication and confirmation of transparent conduct and communication values.

Increased importance is being given around the world to expressions such as social responsibility, corporate ethics, corporate governance and environmental

respect. These expressions have a single common denominator associated with the restoration of effective relations with the institutions companies interact with, and are first manifested in corporate decisions. Hence, corporate governance has evolved from a situation of pre-eminent attention by shareholders and financial responsibility to being of clear importance to all stakeholders and all corporate functions (legal/administrative, financial, social and environmental).

By way of example, the following situations used to exist quite often:

- boards of directors chosen exclusively by shareholders (usually majority shareholders) and management based on political favours, ready to ratify previously reached decisions and to sign previously written minutes;
- significant information/communication asymmetry, with excessively concise, vague or manipulated messages released externally;
- collusion between top management and financial institutions aimed at transferring established risk to less informed operators, who therefore become the weakest (and the most susceptible to failure) links in the chain.

Today, these behaviours come up against a proliferation of stakeholders protection associations, the development of codes of conduct and increasingly precise international (European and American) and national regulations<sup>3</sup>. Corporate management is progressively widening its aims: it has to deal with the entire network of internal and external relations by means of an approach based on the exchange of information and on the optimisation of conduct to satisfy expectations.

Recurring partiality in the preferred decision variables chosen by companies combined, with processes that are too often aimed at satisfying certain parties to the detriment of others, therefore highlight the need to reaffirm the critical importance of the correlation between the potential for long-term success and the adequate satisfaction of all legitimate expectations. Moreover, the main focus on short-term economic-financial results (as a means to measure capital provider satisfaction) must give way to a global vision aimed at attributing importance to the means by which the totality of corporate responsibilities are assumed over time.

Companies are therefore called upon to introduce major governance and management changes, and give new importance to factors such as: overcoming excess emphasis on the revenue contribution of various options (while still considering the significant values) by expanding baseline factors and parameters; legitimising practices and communications by developing the appropriate means to check procedures and information; integrating qualitative and quantitative aspects of business organisation and analysis; promoting potentially beneficial situations based on the appropriate value recognition of intangible resources that are essential for achieving the prerequisites for long-term success; examining and monitoring risks; selective improvement of reports to ensure full compliance with information completeness and transparency requisites.

The important factors used for assessing companies have grown in number, internal and external control procedures to ensure effective business development have multiplied, and communication – inside and outside the company – has become increasingly important. It has therefore become necessary to define codes of conduct in all industrialized nations – especially for large corporations with wide-ranging financial sourcing – aimed at ensuring the moderation of interests

converging in the company, regardless of the degree to which various corporate elements are involved in management.

The need to rationalize behaviour in order to create positive relations between a company and its environment is even more urgent in the current state of global markets, the frequent separation of ownership and management, rapid change and the limited time available for assessment processes.

Globalisation – with the progressive reduction in differences between spatial references, cultures, IT systems, traditions and institutions – seems to mean standardised approaches to governance internationally. Moreover, the weakening in geographic market separators and the removal of obstacles to the circulation of capital tend to complicate competitive barriers. This applies to the acquisition of resources as well as to business development and the allocation of technical, production, financial and corporate results.

Over recent years, there has been a continuous search for optimum governance models that, given current differences, maximise corporate growth value potential based on absolute bona fides and transparency. In particular, importance has been given to management choices (that determine the rationalization of acquired resources, business developed and results achieved) and the ability to form positive relationships with all classes of potentially involved stakeholders, regardless of their geographic location.

### **3. The Stakeholder View and Risk Minimization**

Adoption of the stakeholder view implies a profound change in company performance assessment: one must adopt a multifaceted point of view, based on the equitable balance between competitive, financial and socio-environmental variables. The ability to respond properly to owner expectations is always important, but must be linked appropriately to satisfying expectations from the other parties in a company's domain to respect for the environment. A company's viability is ensured and risk is minimized by operating in this manner.

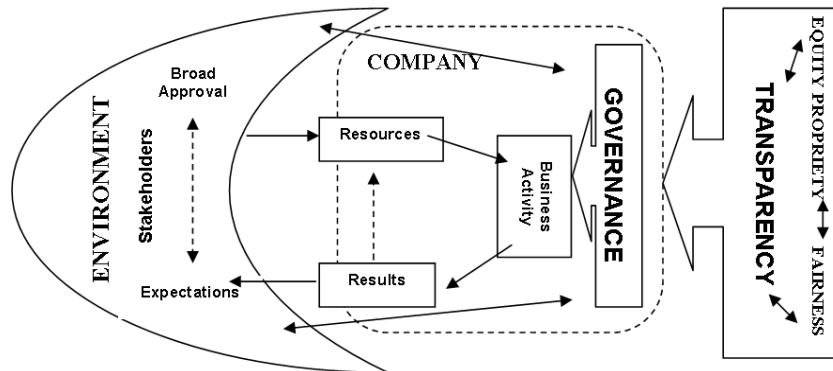
Relations with stakeholders, an essential element in a company's success, must therefore be reassessed. This element depends on methods used to satisfy expectations over time and on interaction and communication choices. In this regard, modern governance is significant precisely because it ensures the long-term, adequate satisfaction of all legitimate expectations, thereby ensuring that a company has necessary broad approval, resources and relationships (Figure 1).

Governance presupposes the consideration of two fundamental conditions, i.e., that:

- only competitive companies, that are able to respond adequately to market needs and create value, can make a long-term contribution to sustainable growth; and
- the ability to obtain broad approval and qualitative resources suitable for sustaining company growth and internal productivity depends on effective interaction with all classes of stakeholders, with long-term consequences for financial result optimisation and company value.

Resource procurement, the best use of resources to create business activities aimed at obtaining high-quality, unique offerings in line with customer expectations and the ability to create wealth and allocate it equitably are all elements that contribute to defining interaction methods between companies and the environment based on corporate excellence. The primary method determinants are conformity to the requisites of equity, fairness and transparency, which should permeate an effective and proper approach to corporate governance.

**Figure 1:** *Conditions for Effective Governance*



There are usually numerous stakeholders involved in a company's growth, often with expectations that tend to influence the potential for long-term positive relationship creation. It follows that a company's prospects for success are influenced by the composition of numerous interests within an approach based on risk minimization and performance optimisation. The convergent interests in a company are interrelated but differentiated over space and time, and involve the financial, competitive and social spheres. Appropriate interaction amongst the various parties (risk capital providers, employees, borrowed capital providers, customers, suppliers, financial analysts, local community, etc.) takes on a composite character that focuses on protecting assets and achieving satisfactory financial results in conformity with the essential conditions of long-term survival, independence, legality, social equity and environmental protection.

The functional links between stakeholder view and prospective risk situations innate in a company are obvious. In essence, the more a company satisfies society's stakeholders expectations in conformity to law, the more it tends to gain broad approval and resources, in ways that also allow it to more easily overcome negative situations.

Maintaining satisfactory corporate effectiveness levels requires careful evaluation of external and internal relations, as well as links amongst expectations, management policies, conduct, results and communication. All of these indicate governance processes that follow an ideal line starting from top management, involving the entire organization and determining the conduct of each element.

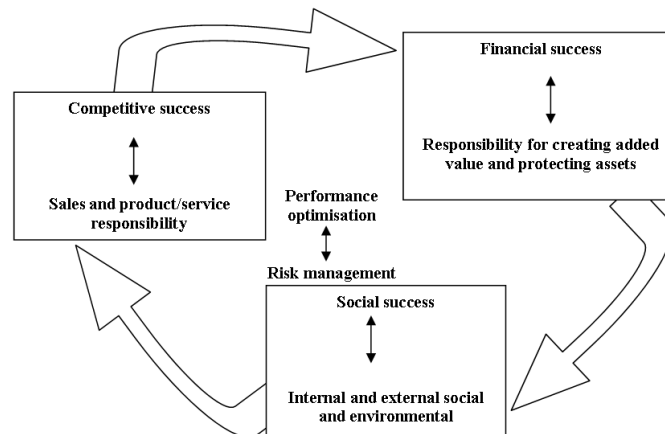
Every company is required to evaluate expectations and translate them into appropriate strategic policies. It must convert instructions from executive levels into management practices and check the consistency of corporate purposes, management targets and actual results - all in a continuous effort to optimise performance and inter-company relations<sup>4</sup>. In this context, there are obvious

connections between degrees of success, means by which responsibilities are assumed and the ability to manage risk over time (Figure 2).

The ability to effectively and appropriately interact in typical markets, particularly regarding sales, plays a fundamental role. The sales function is used to develop typical cycles and it determines the potential for a return on invested resources and profits. In this regard, a sub-component of corporate responsibility, i.e., sales and product/service responsibility, takes on specific importance.

Creation of the bases for long-term competitive success is strongly influenced by the positive assumption of responsibility with regard to potential customers. To achieve this, the following are essential: a sales message that is true, clear and comprehensible; product/service quality in line with the needs it promises to satisfy; the creation of customer services (if necessary); the development of exceptional abilities to adapt to changing market demands; the adoption of fair practices, even regardless of dominant market situations (for example, as in the case of some utilities in Italy)<sup>5</sup>.

**Figure 2:** *Degrees of Success, Risk Management and Corporate Responsibility*



Competitive advantage linked to the adoption of responsible corporate conduct is even more evident in conditions of over-supply, where the creation of trust-based relationships directs choices to companies and/or brands deemed worthy of approval. The result is a reduction in competitive risk and the consequent increase in potential financial and social success<sup>6</sup>.

The creation of added value through characteristic management processes is the basis for achieving satisfactory financial results. Such results, however, must be achieved by developing optimised processes that provide adequate returns for all the involved elements, especially human resources and the environment.

In strictly financial terms, a medium-long term policy must be adopted during execution of the various management processes and with respect to profit allocation decisions. Costs must be minimized when carrying out management processes. This is in congruence with the full assumption of responsibilities pertaining to: worker health protection and workplace environment quality; appropriate human resource value recognition and satisfactory remuneration based on current skill levels and on the contribution made to business development; respect for the ecosystem. At the same time, profit allocation decisions must consider a satisfactory return for risk capital providers (in line with self-financing demands), alignment with levels of



commitment, the protection of corporate assets, and collaboration with regard to company growth in general. This avoids the risk of impoverishing the company and safeguards its value.

Therefore, corporate risk minimization involves the refinement of management and profit-allocation choices based on equity and appropriateness, and presupposes consideration of all social and environmental variables. A stance in favour of sustainable growth is particularly important from the perspective of a fair return for all stakeholders who contribute resources. Such a stance contributes to company growth in line with available resources without creating a threat to the company. Instead, it provides an opportunity to enhance a company's image and improve the handling of approval.

Corporate system complexity, external dynamism factors and the decision-making spread for proper governance process implementation tend to make the actual manifestation of these phenomena and values difficult to forecast over time. Consequently, there is a need to promote ethical values internally and adopt suitable control systems specifically aimed at optimising management decisions, procedures and information in strict compliance with regulations issued by governance authorities. Responsibility for governance must be reflected in management values and choices based on a logical corporate responsibility system. Internal control systems are essential in order to achieve this.

#### **4. Control Systems and Promoting Responsibility**

Corporate governance processes develop in, and are supported by, internal control systems. Such systems are set up to provide all significant decision-making elements, confer validity to intermediation between stakeholder expectations and management practices, and ensure compliance with regulations and internal rules. They also ensure the completeness and transparency of information from management and reports produced for external purposes. Specifically, governance presupposes the introduction of various types of control, which may vary on the basis of external and internal relationship structures. Such controls may:

- empower entities that form part of the corporate governance organisation (for example, the Board of Auditors, Supervisory Board, Management Control Committee, etc.)<sup>7</sup>;
- be assigned to external, independent units, for example in relation to signing-off on communications (as in the case of independent auditors);
- be created internally by company departments with service functions related to the proper implementation of governance processes (for example, internal auditing, management control, etc.).

Every company is thus required to adopt multiple control mechanisms demanded by complexity. Each mechanism operates independently but jointly in order to maintain effectiveness. In particular, these systems control management and information for risk reduction purposes, and facilitate the optimum adoption - through decisions, actions, procedures and information - of legal, financial, social and environmental corporate responsibilities<sup>8</sup>.

In general, a control activity developed for corporate governance is quite complex and demands several types of action, the most critical of which include:

- a) the implementation of all processes aimed at improving the quality of top management decisions through the ad hoc preparation and organisation of information (for example, risk assessment services structured to offer a view of risks and monitoring systems, rating services, social responsibility analyses and relationship with the environment, etc.);
- b) support for a proper coordinated management practice focus to achieve optimum decision-making by governance authorities and the adoption of responsible, effective and efficient practices;
- c) checking of the formal propriety and content of procedures, practices and information generated by management and presented to governance authorities;
- d) checking the clarity and transparency of information sent to stakeholders and related consistency with known expectations, given conformity to privacy requisites.

The above list – although partial and focused on the main elements – highlights the complexity and internal pervasiveness of tasks that may be assigned to control systems with regard to the proper exercise of responsibility. This leads us to rationalise the subject in an effort to separate the control functions inherent in specific governance activities from control systems that support such governance activities.

The extension of responsibilities throughout all corporate practices may be seen in the proper planning and implementation of support mechanisms that ensure consistency in top management decisions, operations and results. Internal control elements then gain importance, especially the elements concerning how the organisation is directed to achieve results that satisfy legitimate stakeholders expectations responsibly (management control system); the checking of adopted procedure validity and transparency in company practices, compliance with rules, and consistency between stated responsibility and operational processes (internal auditing system).

Clearly, the link between corporate governance and responsible business development is intuitive, given the management function to create efficient corporate conditions and considering the cause/effect relationship between purpose, strategic goals, operational goals and actual results. It follows that in the absence of significant influence from governance authority directives, environmental stance, managerial actions and direction of organizational practices, governance runs the risk of losing much of its usefulness. Alternatively, there may be situations where responsibility is determined by governance authorities and not confirmed by actual managerial practices.

Control seeks to transfer corporate responsibilities to decision-making and implementation processes in order to optimise the potential for success and gain stability in relation to the multi-faceted, continuously changing internal and external environment. The control process tends – directly or indirectly - to involve the entire organization, changes depending on the complexity of demands presented by management and is based on a philosophy of continuous improvement and innovative learning.



Control effectiveness derives from the quality of a company's IT system and from the ability to transmit the fundamentals of corporate responsibility to the entire organization. Failure to transmit information and the ethical values of responsibility to the various managerial functions can compromise the proper implementation of governance decisions - to the company's overall detriment.

In this context, it may be important to define and distribute codes of ethics, suitably shared and consistent with the company's philosophy<sup>9</sup>. In the most complex situations, it may be opportune to create a company code of ethics, perhaps based on the appointment of an Ethics Officer (EO) and on the formation of an Ethics Committee (EC). Nevertheless, internal codes of ethics and responsibility risk producing limited effects - and/or being applied inconsistently - without appropriate control procedures and positive cooperation between the EO and EC and internal control authorities. The EO and EC serve to promote the development of ethically responsible decisions in line with top management direction through the organization and implementation of programs to increase employee awareness of the importance of ethics.

Instead, control authorities conduct internal checks of: code of ethics compatibility with organisations and with relations that restrict or promote employee conduct; the best long-term formulation of procedures; the proper development of management decisions and the proper orientation of practices in order to achieve goals; the convergence of goals and results and their compatibility with responsible management that aims to minimize risks; responsibility for the consequences of actions that conflict with requirements; inter-company communication transparency and the propriety of procedures extending operating responsibility in the company.

In the context of corporate economics, this control is a guarantee that governance policies are transferred to the organization, to that part of the wider management system that is closely linked to systems such as: planning, remuneration, career and incentives, the promotion of ethics, information and communication. In other words, this structured, integrated system handles information and processes and transforms top management guidelines into organizational practices based on the rational coordination of operations and respect for codes and rules of conduct.

Therefore, control is assuming ever-wider meanings in relation to the development of governance. It is changing from a strictly efficiency and operational-based legitimacy - traceable primarily to financial processes and respect for the law - to one that pervades all aspects of management and balances the assumptions of effectiveness and efficiency in order to optimise performance.

If correctly structured and accompanied by checks on procedural correctness and compliance with principles of responsibility and ethical conduct, focusing on closed-loop relations with regard to expectations, resources, operations and results allows governance policies to be implemented. Consequently, corporate governance presents concrete ways to create positive relations with stakeholders.

## 5. Conclusions

The above considerations emphasize that corporate governance essentially refers to the assumption of responsibility when defining relations with all of society, and

that implementation presupposes processes to extend responsibility values throughout an entire organization. In effect, governance is a means for intermediation between stakeholders and management, and transmits to company practices and activities the best methods to satisfy external expectations in conformity to current restrictions and to essential assumptions for long-term success. This last element is strongly influenced by the ability to adopt practices aimed at the equitable treatment of all legitimate expectations converging on a company – treatment necessarily based on the assumption of responsibility regarding respect for rules, the maintenance of balanced economic conditions, and respect for society's expectations and the ecosystem.

Therefore, governance authorities are the main guarantors of the adoption of responsible practices. The implementation of such practices in terms of effectiveness, efficiency and productivity depends on the ability to transmit proper governance guidelines to the entire organization, in full conformity to responsibilities at various decision-making/operational levels.

The management and relational guidelines chosen by governance authorities from time to time should be conceived as a single block, based on unique stakeholder expectations, on the qualitative/quantitative characteristics of available resources, and on restrictions and opportunities in the relevant context. Implementation requires a generalized and hierarchical approach founded on sustainable growth, and necessarily based on:

- styles of conduct and shared values that tend to opportunely merge the economic, social and environmental aspects in full respect of laws and ethical principles;
- control systems that ensure the proper implementation of selected guidelines thereby minimizing risks and optimising results;
- emphasizing cause/effect relations between variables, activities and results in the context of a unitary company system.

In such a context, global responsibility values are essential for integrating corporate governance and control authorities in order to develop a company that can achieve competitive, financial and social success. The full assumption of responsibility values in all corporate decisions and actions makes it easier to gain approval from stakeholders, obtain resources needed for growth and limit corporate risks.

Moreover, the unitary nature of the corporate system tends to emphasize interrelations between factors closely linked to interaction modes with the environment and the selection of factors associated with the internal organisation in order to implement governance choices effectively. It also emphasizes the importance of the quality of governance decisions for the full adoption of responsibility, in the light of the continuously increasing overlap of internal and external social variables, competitive variables and economic variables.

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## Notes

<sup>1</sup> G. Zappa, *Le produzioni nell'economia delle imprese*, volume 1, Giuffrè, Milan, 1956, p. 79.

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<sup>2</sup> The stakeholder theory was fully developed in: A. B. Carrol, *Business and society: ethics and stakeholder management*, South Western, Cincinnati, 1993; W. M. Evan and R.E. Freeman, *A Stakeholder Theory of the Modern Corporation: A Kantian Capitalism*, T.L. Beauchamp, N.E. Bowie (eds.), *Ethical Theory and Business*, Prentice Hall, New York, 1993; p. 79, 4<sup>th</sup> ed.; J.E. Post, L. E. Preston, S. Sachs, *Redefining Corporation*, Stanford U.P., Stanford, 2002.

<sup>3</sup> A significant stimulus for change in Italy is contained in the proposal by Borsa Italiana, published in 1999, for a 'code of conduct' for listed company governance (Preda Code). Subsequently, Law Decree no. 6 of 17 January 2003 reformed corporate law and expanded the types of governance organisation (traditional system, monistic system, dualistic system) and established (art. 2409) that at least one third of the board of directors must have the requisites of independence and, if required by the by-laws, 'requisites demanded by codes of conduct written by industry associations or by regulated market organisations.'

<sup>4</sup> D. M. Salvioni, *Corporate effectiveness, governance processes and intangible resources*, in D. M. Salvioni, *Corporate governance, control of management and intangible resources*, Franco Angeli, Milan, soon to be published, p. 15 et seq.

<sup>5</sup> In this regard, it seems appropriate to remark that the de facto monopoly situation still existing in some public utility services with regard to customer localization and supplier concentration (for example, methane gas, electrical energy, etc.) may induce companies to take unfair advantage due to an imbalance in contractual power with regard to customers, unless accompanied by consistent governance. In other words, being the sole supplier of services could induce companies to raise rates by using methods that are not entirely ethical. In this case, it is essential to adopt forms of political governance and develop consumer associations to prevent the transfer of corporate financial risk to the weakest link in the chain.

<sup>6</sup> A recent analysis performed by Corporate Social Responsibility (CSR Europe) on a sample of 12,000 European consumers revealed continuously increasing sensitivity to social variables. In fact, 70% of those interviewed said the attention that companies pay to such variables influences their product purchases and 58% stated that corporate approaches to social problems were lacking.

<sup>7</sup> Amongst the tasks that new corporate law assigns to the board of auditors, supervisory board and management control committee, one of the most important is supervision of conformity to principles of proper administration and of adequacy of the organizational structure, the internal control system and the accounting system, as well as accounting system reliability in the presentation of management events. It also seems opportune to emphasize that, in this context, questions such as auditor control functions, the board of directors, the supervisory board or other corporate governance organisations are treated marginally and in a perfunctory manner so as to simply understand the functional links between governance and control.

<sup>8</sup> Recent governance studies (normative, professional and theoretical) tend to emphasize the concept of 'internal control system'. However, an analysis of the various papers reveals an often partial and definition-based approach that very rarely focuses on a global vision of proper and efficient corporate operations. Specifically, little attention is paid to the internal control function in support of corporate governance quality; relations between the various forms of necessary practical control and between such forms and corporate responsibility, are not sufficiently clear.

<sup>9</sup> Corporations such as IBM, 3M, General Electric, Boeing, Champion International, Chemical Bank, General Dynamics, General Mills, GTE, Hewlett-Packard, Johnson & Johnson, McDonnell Douglas, Motorola, Texas Instruments and Xerox are only some of the many companies which, near the end of the last century, produced formal ethics programs and adopted codes of ethics. For a presentation and assessment of some of these programs, C.F.: *Corporate Ethics: A Prime Business Asset*, The Business Roundtable, New York 1988; A. Goodell, *Ethics in American Business: Policies, Programs and Perceptions*, Ethics Resource Center, Washington D.C. 1994; G.R. Weaver, L.K. Trevino, «Attitudinal and Behavioral Outcomes of Corporate Ethics Programs: An Empirical Study of the Compliance and Values-Oriented Approaches», *Business Ethics Quarterly*, 9, 2, 1994, pp. 315-335; and D.L. McCabe, L.K. Trevino, K.D. Butterfield, The Influence of Collegiate and Corporate Codes of Conduct on Ethics - Related Behavior in Workplace, *Business Ethics Quarterly*, 1996, pp. 461-476.