Corporate Social Responsibility
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Lecture – 41
Corporate Governance and Corporate Social Responsibility

Welcome back to the MOOC course on Corporate Social Responsibility. My name is Aradhna Malik and I am helping you with this course and today we are going to wrap up the discussion on corporate governance. So, these last two lectures are going to focus on corporate governance and how whatever we have discussed till now contributes to corporate social responsibility why is corporate governance necessary for corporate social responsibility which is what this course is all about.

Now, like I told you I am not going to give you tips, I am not going to give you pointers, I am just going to make you aware of the kinds of research that has gone on in this area in different parts of the world and I will let you decide for yourself whether corporate governance should be required to enhance corporate social responsibility or not, and if yes how and how much of corporate governance and what shape or form should it be useful in your particular contexts.

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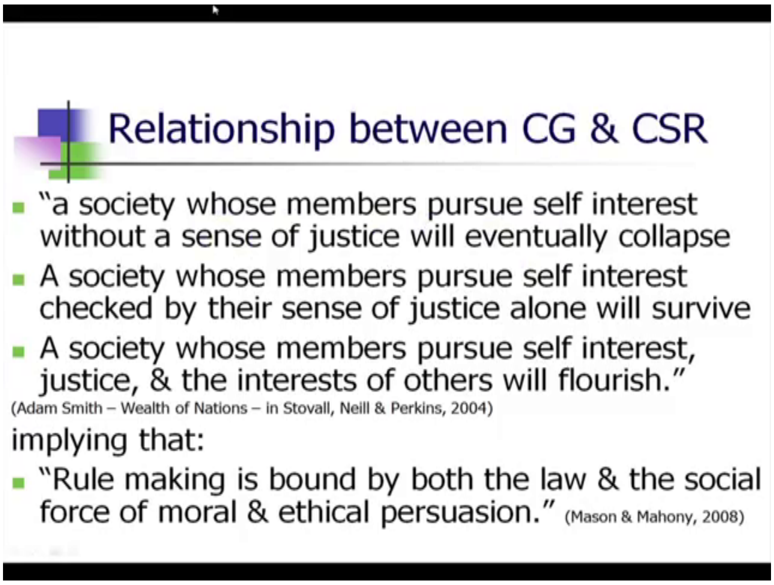

So, let us see what we have for you here now the relationship between corporate governance and CSR was very nicely summed up in a very very old book called the wealth of nations by Adam Smith a classic and economics. And he said that a society whose members pursue self interest without a sense of justice will eventually collapse. A society whose members pursue self interest checked by their sense of justice alone will survive, a society whose members pursue self interest justice and the interests of others will flourish.

So, the indication was that you know if you look after the society that you live in, if you look after the interests of others that in turn will serve you to enhance your interests. So, amazing statement very very applicable to why corporate social responsibility is important for organizations. Now this implies that rulemaking is bound both by the law and the social force of moral and ethical persuasion when we make rules.

When we make rules, we make rules of course, to restore order in society, but rules also need to be based on the cultural fabric of the society that we live in. So, culture determines to a great extent which rules are made and how they are implemented in how sorry how they are enforced and only then can an organization that is rooted in the social fabric survive and flourish.

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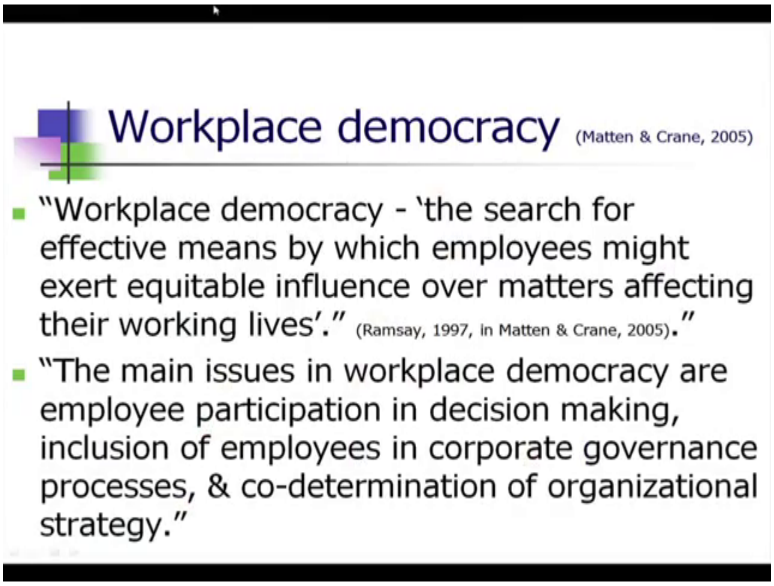

Now, workplace democracy refers to the search for effective means by which employees might exert equitable influence over matters affecting their lives. The main issues and workplace democracy are employee participation in decision making, inclusion of employees in corporate governance processes and co determination of organizational strategy. So, when we make rules we are talking about when we talk about corporate governance.

We are talking about rules we are talking about a structure and workplace democracy is you know having the people who are going to be affected by that structure participate in that rulemaking and there then you know having the two the dynamics between rulemaking and the inputs by the people who are going to affected by rulemaking influence each other and these dynamics then shape what kinds of rules are made and how they are enforced.

So, that is what workplace democracy is workplace democracy means that you know you have the people who the employees participate in the decision making process, include them in the corporate governance and jointly determine the organizational strategy.

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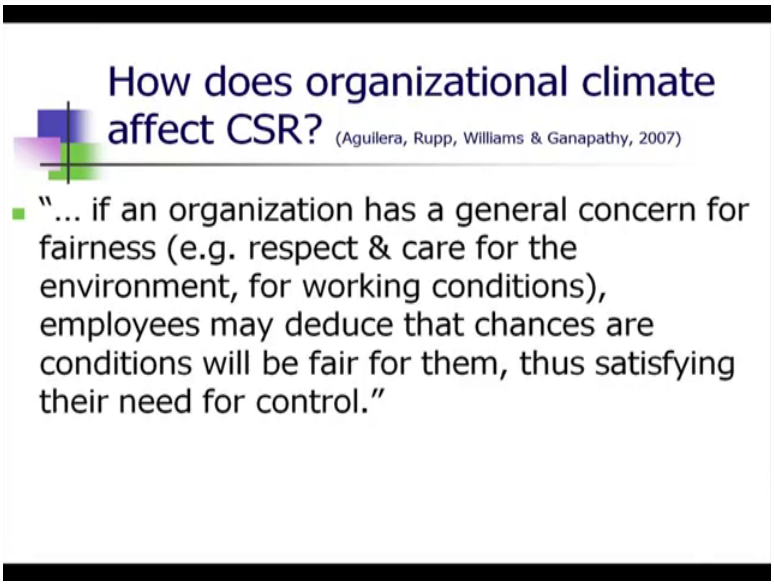

How does organizational climate affect corporate social responsibility? Organizational climate refers to the general environment the social environment within an office within an organization.

Now, if the organization has a general concern for fairness for example, respect and care for the environment and for working conditions, employees may reduce that the chances are that the conditions will be fair for them as well thus justifying their need for control over their own environments and in turn influencing how you know they feel connected to the organization.

So, organizational citizenship behaviour will be enhanced and a sense of belongingness within the organization will be enhanced and that in turn will influence their job performance. All of these things are linked you treat everything around you fairly and justly and you take care of things around you, the word goes out that if you taking care of the environment if you taking care of your employees if there is democracy in the workplace then the employees will feel more connected they will feel more committed to the organization and their work will be done well.

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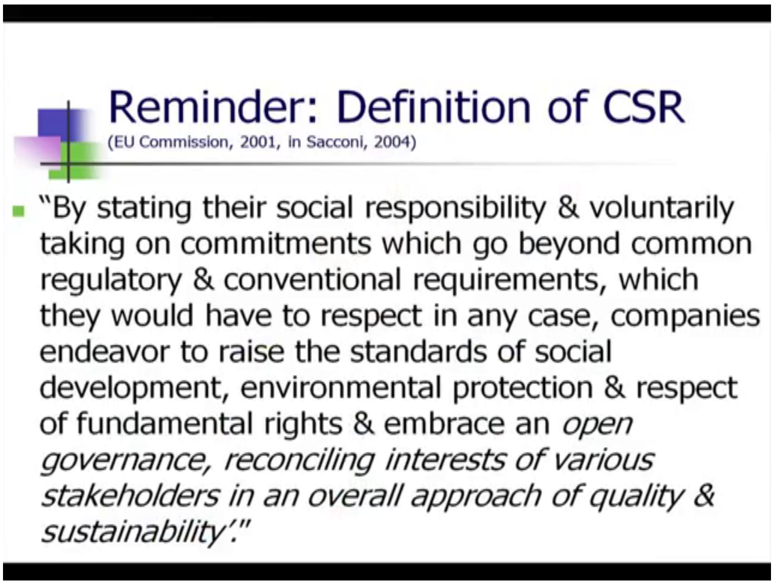

Now, back to a reminder of the definition of corporate social responsibility. By stating their social responsibility and voluntarily taking on commitments which go beyond common regulatory and conventional requirements which they would have to respect in any case, companies endeavor to raise the standards of social development environmental protection and respect of fundamental rights and embrace and open governance reconciling interests of various stakeholders in an overall approach of quality and sustainability.

Now, this definition was given by the European union commission in 2000 and it is been quoted in a paper by Sacconi which was published in 2004 and I will be drawing extensively on the paper by Sacconi amazing paper I will give you the reference I am sure you know you can find this paper through your databases in your own libraries in your institutions.

So, you know we European union definition also says that if we look after the interests voluntarily of things that we are supposed to look after even though it is not governed by the law. The chances of the stakeholders believing in us will be higher and that will in turn feed into the credibility of the organization and take the organization further.

So, an benchmark will be set for social development because organizations profit making organizations have a very large role to play in any society, in any social structure you know they are contributing to the development of the society they are contributing there they sending out products they are employing people. So, they are a part of the social fabric and if they set the standards for how the environment should be treated, how their employees should be treated people begin to follow that. And you know the more powerful or the larger the organization is the more relevant it is to the lives of people, the more visible it becomes to people and therefore, the responsibility of setting such standards increases for that organization.

So, that really is what this definition is talking about and that is where corporate governance which in turn is a you know the reason for corporate governances, accountability, fairness, transparency and credibility. These reasons then of course, you know then the you know if you have a strictly governed organization then peoples belief in that organization will be enhanced.

And you know if its connected to CSR and that is where we are going with this and I will give you real facts about how corporate governance effects the CSR, but just to give you a brief overview it will enhance peoples belief faith in the organization and therefore, it could bring in more profits also and of course, it sets standards for social development etcetera, so ok.

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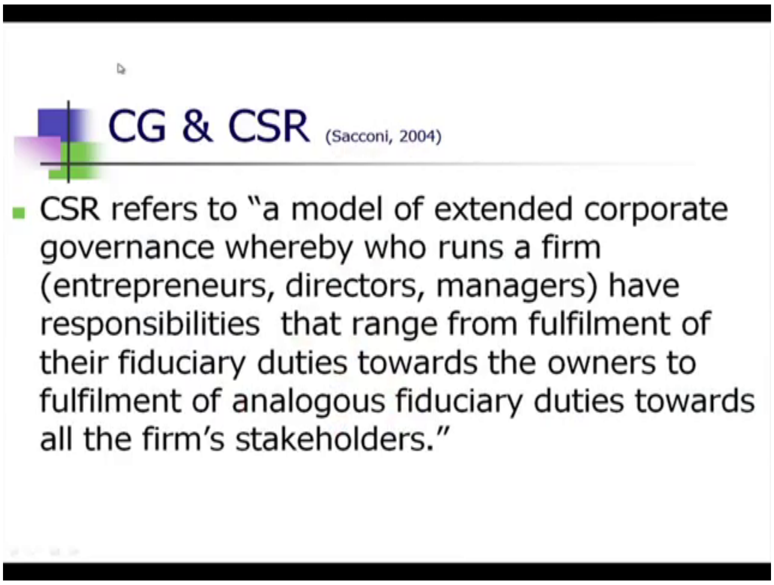

Corporate governance and CSR, CSR refers to a model of extended corporate governance this was proposed by Sacconi in this paper whereby who runs a firm entrepreneurs directors managers have responsibilities that range from fulfillment of their fiduciary duties towards the owners to fulfillment of analogous fiduciary duties towards all the firms stakeholders that primary fiduciary duty towards the owners of the firm is financial.

Now, when we talk about fiduciary duties we are talking about you know the trust that people have placed in them. So, the primary duty is towards the owners which is financial and then they are also they that is a direct fiduciary duty the analogous fiduciary duties could be the trust that others have placed in them to do their work ethically and to the best of their ability.

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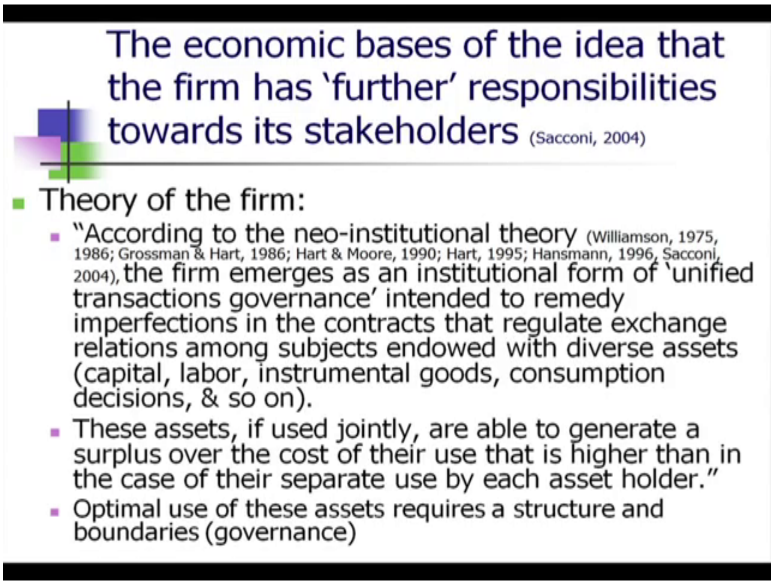

The economic basis of the idea that the firm has 'further' responsibilities towards its stakeholders. So, I am sorry about the semicolon here it should actually be a comma and I will just fix that here. So, all right it should be an apostrophe here or an inverted comma. So, the economic basis of the idea that the firm has further responsibilities towards its stakeholders.

The economic basis come from the theory of the firm according to the neo institutional theory the firm emerges as an institutional form of unified transactions governance intended to remedy imperfections in the contracts that regulate exchange relations among subjects endowed with diverse assets. So, it is a firm is nothing, but a place for transaction or a place for regular exchange relations among people who have different kinds of assets.

So, somebody has money somebody has labour, somebody has you know the instrumental goods, somebody wants to consume or somebody makes the decisions for consumption etcetera. So, a firm is a place where these transaction decisions take place it is a where these exchanges take place. So, that is the theory of the firm. These assets if used jointly are able to generate a surplus over the cost of their use that is higher than in the case of their separate use by each asset holder.

So, if the assets that are pooled in are used are collected and organized and used jointly by different people then the cumulative value of the joint usage of these assets results in a surplus output which is then shared by the stakeholders by the people who are investing into that firm. So, that is the theory of the firm. Now optimal use of these assets requires a structure and boundaries and that is where governance comes in.

How do we know that these assets are being used properly effectively adequately appropriately? Governance is required to make sure that that happens in governance the primary, the primary responsibility of governance is to have a logical documented basis for the decisions that are taken by organizations. Again arbitrariness of decisions is antagonistic to governance you know their decisions are taken arbitrarily in many cases and that really is against all logical governance.

So, if the decisions are taken on sound logic and that logic is documented then things fall into place and transparency is an outcome of that and accountability increases. So, you know the assets are used in a manner if these assets are used effectively and the reasons for using these assets in a certain way are documented then the accountability the transparency of that organization increases. And in order to use these assets properly the firm needs a structure, it needs some boundaries, it has to define you know how much where when how things are going to be used and how their output is going to be calculated and measured.

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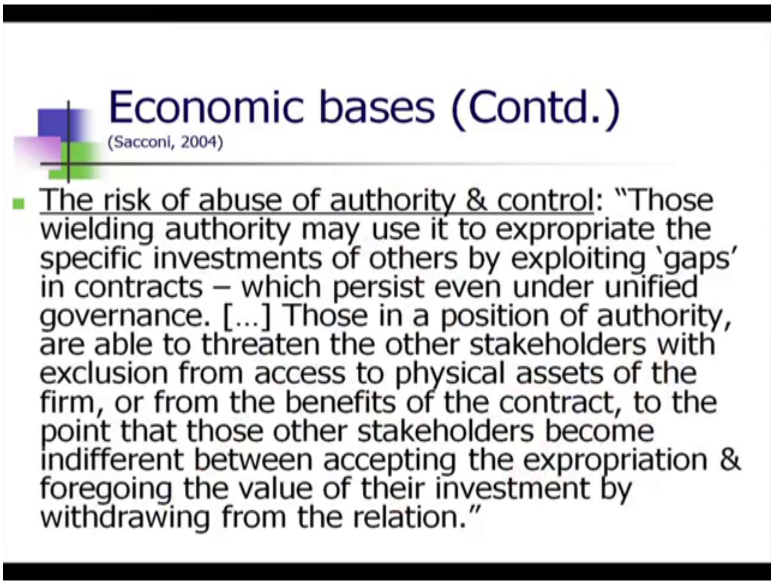

The risk of authority and control those wielding authority may use it to expropriate the specific investments of others by exploiting gaps in contracts which persist even under unified governance, which means that those in a position of authority are able to threaten the other stakeholders with exclusion from access to physical assets of the firm or from the benefits of the contract to the point that those other stakeholders become indifferent between accepting the expropriation and foregoing the value of their investment by withdrawing from the relation. So, when people start abusing their authority when people start you know abusing their control over these assets.

Then the people who have invested in the firm start withdrawing from it, it could be people, it could be employees, it could be investors, it could be anyone who has invested they just start cutting their losses and moving on because when it becomes. So, bad when they are cornered, or when the people who control the assets you know prevent the stakeholders from reaching those assets you know and start exploiting the gaps and preventing people from reaching those assets. Then the people who can reach those assets or who have a right to those assets just say fine we invested in it and we will just cut our losses and move on and that is where things start failing. So, that is the risk of abuse of authority and control.

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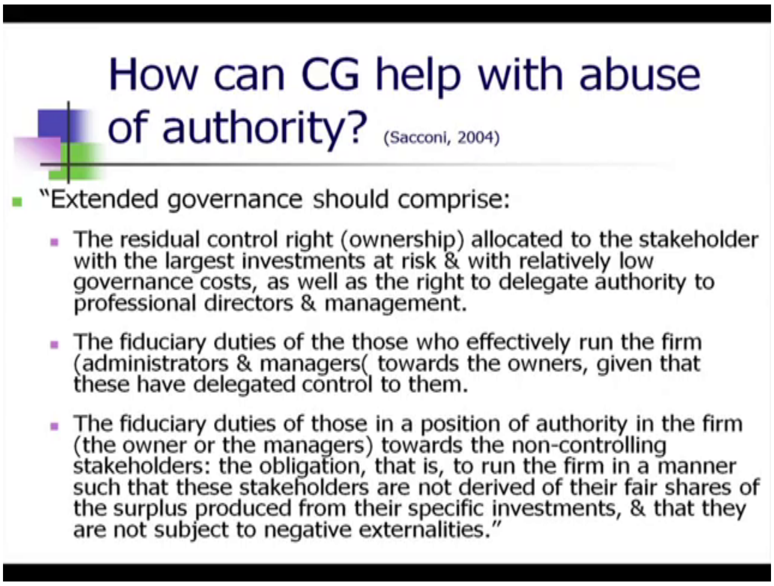

Now, extended governance how can corporate governance help with abuse of authority. When we talk about extended governance when we talk about responsibility to our stakeholders we need to have certain ground rules in place. And Sacconi suggests that extended governance should include the residual control right or ownership allocated to the stakeholder with the largest investments at risk and with relatively low governance costs as well as the right to delegate authority to professional directors and management. The fiduciary duties of those who effectively run the firm administrators and managers towards the owners, given that these have delegated control to them.

The fiduciary duties of those in a position of authority in the firm the owner or the managers towards the non controlling stakeholders the obligation that is to run the firm in a manner such that these stakeholders are not derived of their fair shares of the surplus produced from their specific investments and that they are not subject to negative externalities. So, we need to lay down a process that that facilitates the fair distribution of the surplus that is generated. That prevents any undue abuse of authority that prevents any undue barriers between the authority controlling the assets and the surplus generated by these assets and these stakeholders who have a right to this surplus.

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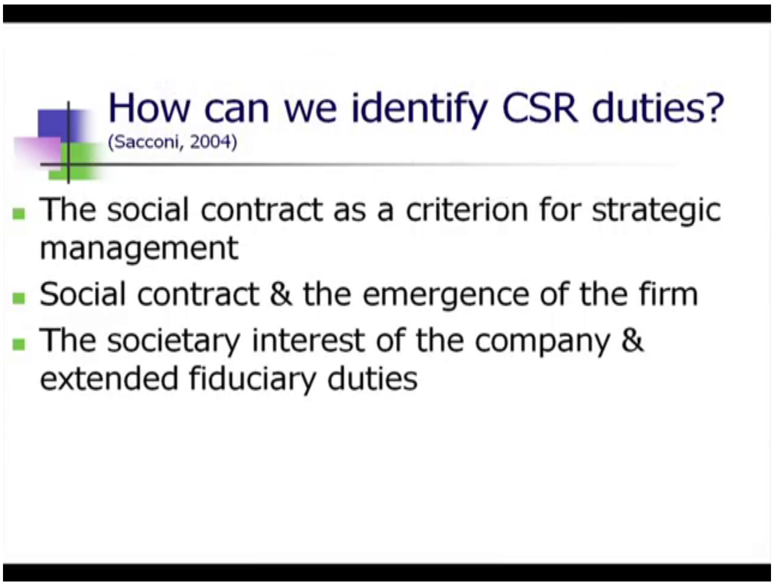

Now, how do we identify CSR duties? Sacconi suggests that three methods one is of course, the philosophy is behind these you know the social contract is a criterion for strategic management, social contract and the emergence of the firm and societary interest of the company and extended fiduciary duty.

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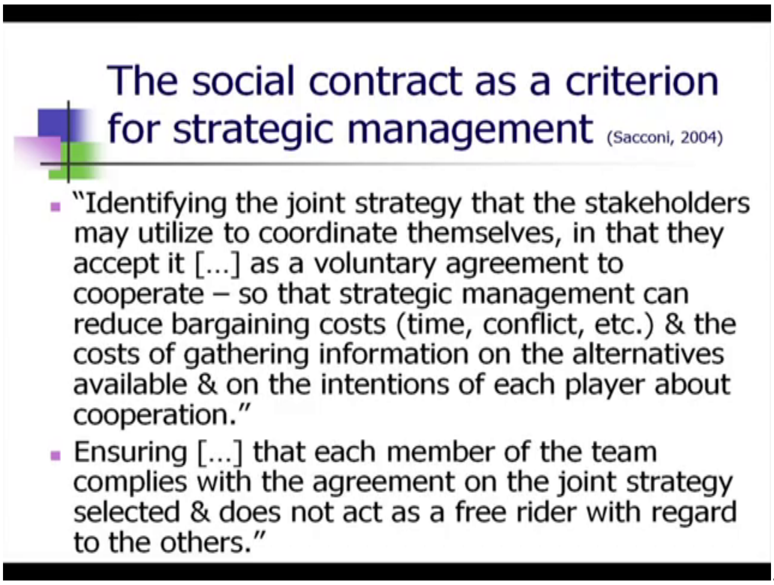

So, let us look at each of these in detail. Social contract is a criterion for strategic management Sacconi says that you know we need to identify the joint strategy that the stakeholders may utilize to coordinate themselves in that they accept it as a voluntary agreement to cooperate. So, that strategic management can reduce bargaining costs and the costs of gathering information on the alternatives available and on the intentions of each player about cooperation and ensuring that each member of the team complies with the agreement on the joint strategy selected and does not act as a free rider with regard to the others.

So, a joint strategy needs to be identified where stakeholders participate and agree to doing their bid and then getting the benefit out equitably. And you know somehow it needs to be ensured that there are no free riders that everybody is doing what they are required to do in order to generate this surplus or managing the firm in a strategic manner, so that as much surplus is generated as possible.

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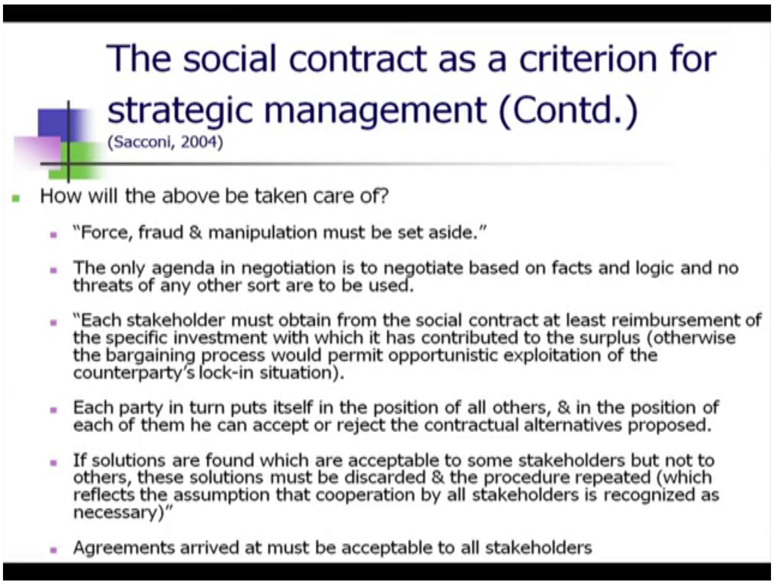

Now in order to do this how can the above be taken care of force, fraud and manipulation must be set aside. The only agenda in negotiation should be to negotiate based on facts and logic and no threats of any sort should be used. People should you know there should be a clear definition of how negotiations need to take place, no threats, no manipulation negotiation should only mean negotiation on logic not negotiation because I am in power I have the right to do this you know that kind of thing should not be there.

Each stakeholder must obtain from the social contract at least reimbursement of the specific investment with which it has contributed to the surplus otherwise the bargaining process would permit opportunistic exploitation of the counterparties lock in situation. So, people who have invested in the firm should if they come to the bargaining table the negotiation should be conducted in such a way the transactions should be conducted in such a way that they get at least what they have invested in it back, you know there should be no undue exploitation of the gaps to take over what others have invested. Each party in turn puts itself in the position of all others and in the position of each of them he can accept or reject the contractual alternatives proposed. So, you know each party should commit to seeing the others point of view and should be in a position to reject the alternatives that have been proposed.

If solutions are found which are acceptable to some stakeholders, but not to others these solutions must be discarded and the procedure repeated which reflects the assumption that cooperation by all stakeholders is recognized as necessary. So, everybody should be on board everybody should agree to what has been agreed upon and agreements arrived at must be acceptable to all stakeholders, everybody participating in the situation should agree with the decisions that have been taken nobody should feel that they are being disadvantaged in anyway.

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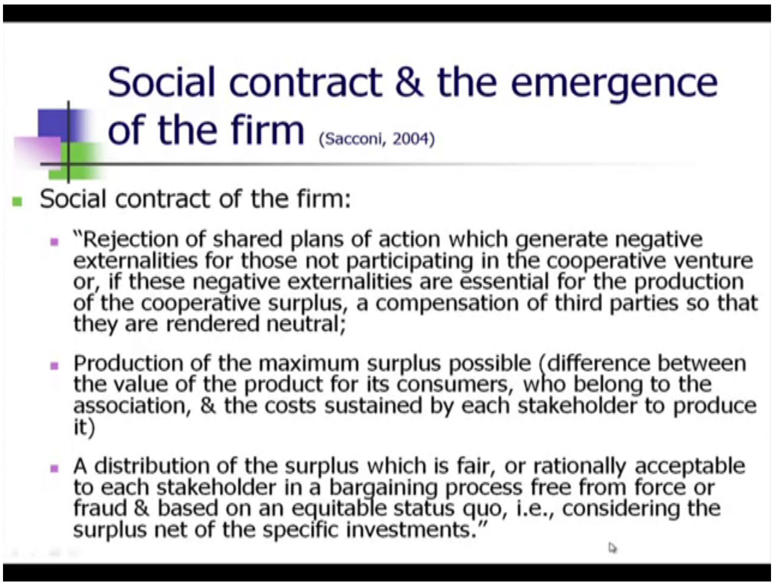

The next one is social contract and the emergence of the firm. Now what is the social contract of the firm? Rejection of shared plans of action which generate negative externalities for those not participating in the cooperative venture or if these negative externalities are essential for the production of cooperative surplus a compensation of third parties. So, that they are rendered neutral.

Production of the maximum surplus possible difference between the value of the product for its consumers who belong to the association and the costs shared by each stakeholder to produce it not productive I am sorry about this mistake here. So, I just fixed this again I am sorry about this and the costs sustained by each stakeholder to produce it.

Production of the maximum surplus possible difference between the value of the product for its consumers who belong to the association and the costs sustained by each stakeholder to produce it the third one is a distribution of the surplus which is fair or rationally acceptable to each stakeholder in a bargaining process free from force and fraud and based on an equitably equitable status quo that is considering the surplus net of these specific investments.

So, this is all you know jargon, but what it really means is an I wanted to put this and, you know those of you who are interested in this kind of a detailed understanding of how the theory of the firm propagates and how it feeds into CSR should understand it or they might find this useful, but what it really means is that the investors the stakeholders should have the power to reject the decisions that have been taken.

And you know it is the responsibility of the people managing the firm to generate as much surplus as possible and aid the distribution of the surplus should be fair equitable and acceptable to those who have invested in it, you know given certain rules and it should be free from force or fraud and it should be based on a an equitable system of distribution rather than force of fraud and saying that this is all you will get take it or leave it.

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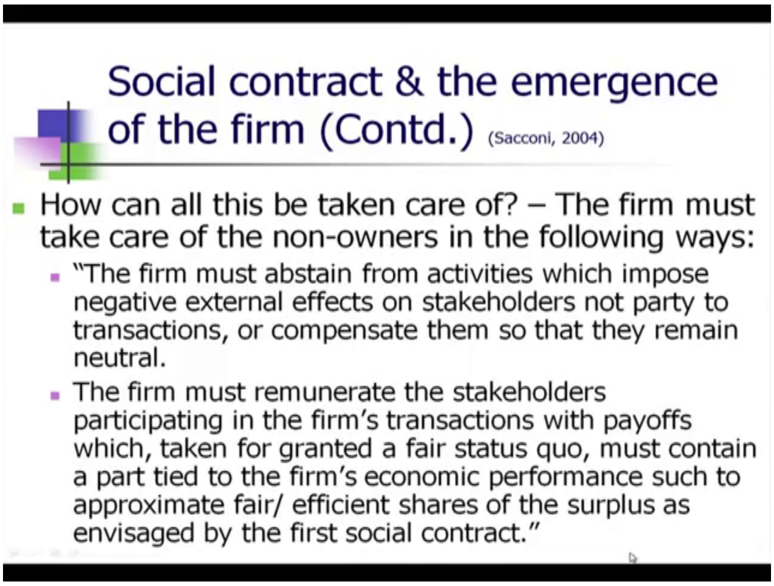

So, how can all this be taken care of? The firm must take care of the non owners in the following ways. So, owners of course, get their fair share, but the non owners can be taken care of in the following manner the firm must abstain from activities which impose negative external effects on stakeholders not party to transactions or compensate them so they remain neutral.

The firm must remunerate the stakeholders participating in the firms transactions with payoffs which taken for granted a fair status quo must contain a part tied to the firms economic performance such to approximate fair or efficient shares of the surplus as envisaged by the first social contract. So, the firm must give the, you know it should not impose any negative external effects on the people who are not participating in these transactions. And it must remunerate the people participating in the firms decisions in the firms transactions with something that they will feel or which with enough to give them a sense of fairness and you know they must know what is going on and they must get their equitable share of the surplus.

The third one is societary interest of the company and extended fiduciary duties.

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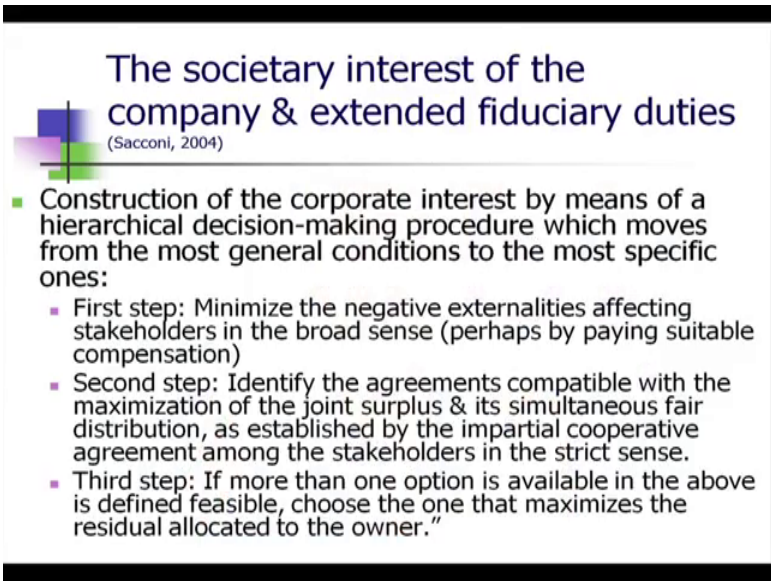

Under this you know the first thing is to the construction of the corporate interest. This means that the corporate interest must be constructed by means of a hierarchical decision making procedure and this is where corporate governance comes in a hierarchical decision making procedure which moves from the most general conditions to the most specific ones.

So, the first step in this is to minimize the negative externality. So, a hierarchical decision making procedure must be put in place which goes from the general to the specific interests and it must be, you know it must be constructed to take care of the corporate interest. First step here is to minimize negative externalities affecting stakeholders in the broad sense perhaps by paying suitable compensation.

Second step in this direction is to identify the agreements compatible with the maximization of the joint surplus. So, earn as much as you can and its simultaneous fair distribution as established by the impartial cooperative agreement among the stakeholders in the strict sense and then the third condition is if more than one option is available in the above is defined feasible choose the one that if defined feasible choose the one that maximizes the residual allocated to the owner. So, once there is fair distribution and everybody is happy then whatever is remaining should go to the owner as the extra left over surplus.

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Now, logic of a CSR strategic management standard why should you have CSR strategic management standard, the reason is that the firms strategic behaviour must conform to a context in a context of incomplete information in order to that reputation effects are reactivated.

So, three points under this - generality and the abstractness of principles, precautionary protocols of behavior, and communication and dialogue with the stakeholders.

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See corporate governance dialogue with the stakeholders and CSR how do you conduct this enunciation of the social contract stating the firms fiduciary duties towards its stakeholders. If the statement is formulated on consultation with the stakeholders its acceptability is ensured and the parameters with which behaviour is assessed are known to both parties.

Internal management and implementation the presence of external members on internal board or committee both corporate or board of directors or those committees set up ad hoc to manage CSR like an ethics committee enables representation of the stakeholders points of view and prevents divergence between the ex post assessment between the two parties.

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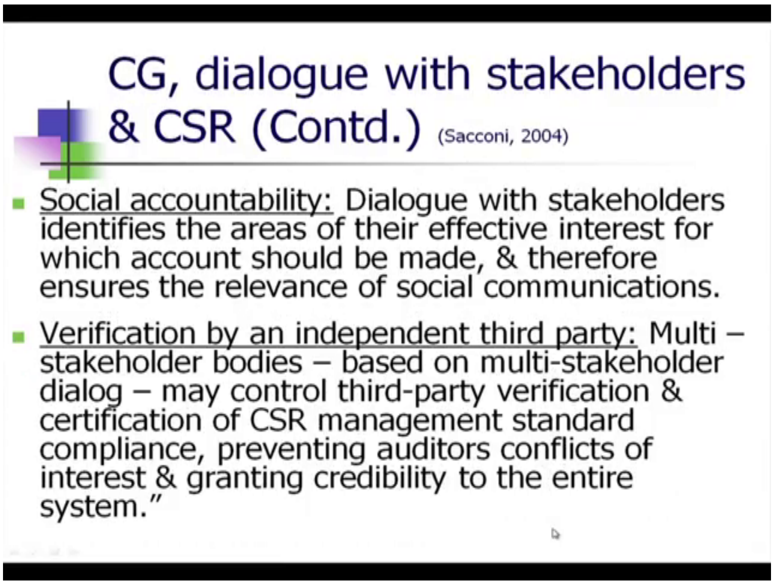

Social accountability is another way in which the dialogue with stakeholders can contribute to linking corporate governance with CSR dialogue with stakeholders identifies the areas of their effective interest for which accounts should be made and therefore, ensures the relevance of social communications.

Then verification by an independent third party. Multi stakeholders bodies a multi stakeholder bodies based on multi stakeholder dialogue may control third party verification and certification of CSR management standard compliance preventing auditor's conflicts of interest and granting credibility to the entire system. So, somebody else looks at how these stakeholder bodies are connected and you know they verify and they certified the CSR management standard and that in turn feeds into preventing the conflicts that auditors may have with the way the organization is being good run.

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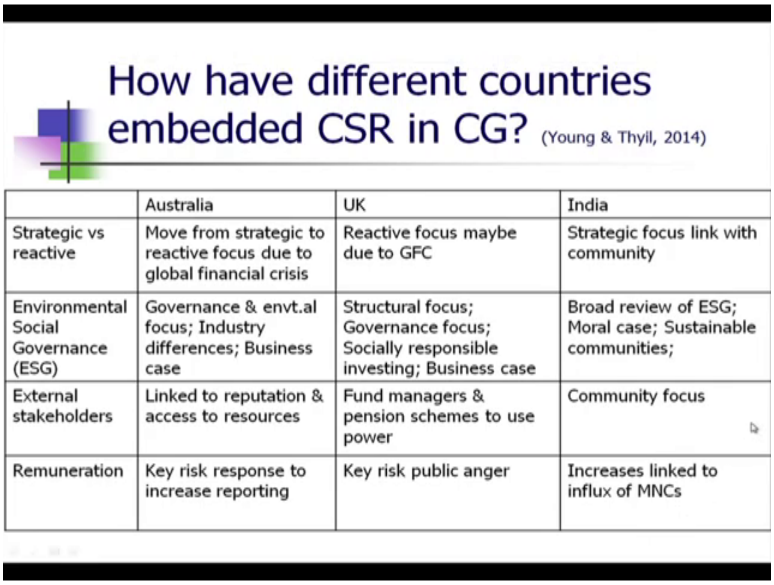

How have different countries embedded CSR in CG? (Young & Thyil, 2014)

	Australia	UK	India
Strategic vs reactive	Move from strategic to reactive focus due to global financial crisis	Reactive focus maybe due to GFC	Strategic focus link with community
Environmental Social Governance (ESG)	Governance & envt.al focus; Industry differences; Business case	Structural focus; Governance focus; Socially responsible investing; Business case	Broad review of ESG; Moral case; Sustainable communities;
External stakeholders	Linked to reputation & access to resources	Fund managers & pension schemes to use power	Community focus
Remuneration	Key risk response to increase reporting	Key risk public anger	Increases linked to influx of MNCs

Now, how have different countries embedded CSR in corporate governance? Again this is you know this was a very nice comparative table that was given by Young and Thyll in, it should be 2024 it should be 2014 I am sorry about this, this should be 2014, ok here.

So, how have different countries taken care of you know CSR right from top to bottom. As far as strategic versus reactive activities are concerned in Australia they moved they have moved from strategic to reactive focused due to the global financial crisis. In UK they have gone to the reactive focus probably due to the global financial crisis, in India again according to the study the strategic focus has been linked with the community as far as CSR is concerned.

Then environmental social and governance ESG parameter the governance and environmental focus is their industry differences are there and thus this is a business case. So, here structural focus as far as UK is concerned the focus on the structure, focuses on governance and socially responsible investing and this is again a case for business which is profit making.

Broad review of ESG which is environmental social and governance initiatives it is a moral case it is the difference between right and wrong and the focuses on building sustainable communities. As far as external stakeholders are concerned in Australia they are found to be linked to reputation and access to resources, in the UK they are found to be linked to the or they found to be links to the fund managers and pension schemes to use power and in India again the external stakeholders are mostly you know the focuses on the community.

Then again according to this study the remuneration here is linked to the key risk response to increase reporting here the key risk in remuneration is response to increase reporting. Here the key risk is public anger and here increases linked to or the increase in remuneration is linked to the influx of MNCs. So, foreign country foreign company is bringing in lots of money.

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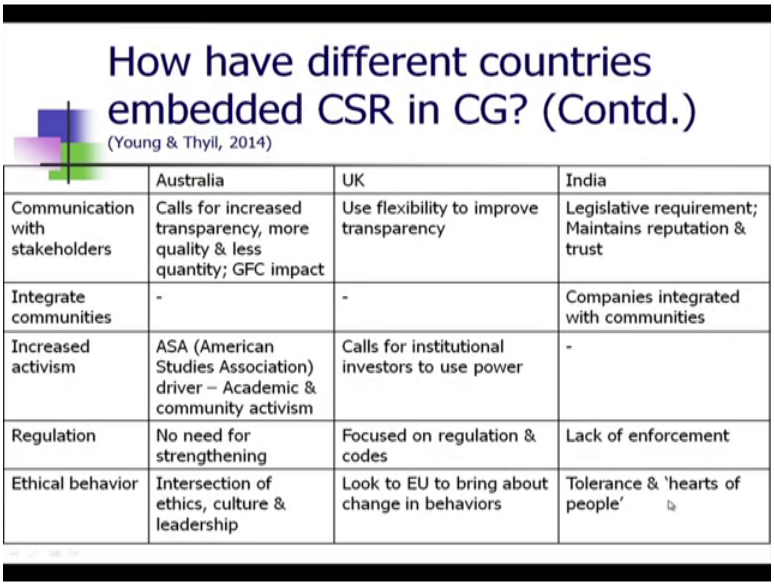

	Australia	UK	India
Communication with stakeholders	Calls for increased transparency, more quality & less quantity; GFC impact	Use flexibility to improve transparency	Legislative requirement; Maintains reputation & trust
Integrate communities	-	-	Companies integrated with communities
Increased activism	ASA (American Studies Association) driver – Academic & community activism	Calls for institutional investors to use power	-
Regulation	No need for strengthening	Focused on regulation & codes	Lack of enforcement
Ethical behavior	Intersection of ethics, culture & leadership	Look to EU to bring about change in behaviors	Tolerance & 'hearts of people'

Communication with stakeholders as far as Australia is concerned it calls for increased transparency more quality and less quantity. In the UK use flexibility to improve transparency, in India legislative requirement communication with stakeholders is a legislative requirement it maintains reputation and trust. As far as integration of communities is concerned this is happening a lot in India the companies are integrated with communities as far as possible.

Increased activism you know, so in Australia they are following the American studies association academic and community activism which is which act as a driver for connecting CSR into corporate governance and strategy in the UK it is calls for institutional investors to use power and they did not find any evidence of this in India they say that activism is yearly anyway high in India.

As far as regulation is concerned Australia has found no need for strengthening regulation, UK has found has focused on regulation and codes and in India for this study found that the there was a lack of enforcement of regulation, but still people are doing whatever they can. As far as ethical behaviour is concerned again I am quoting a study I am an Indian I feel bad about sure sharing this with you, but then again you know this is a research study. So, I have taken this material from that study and I am sharing it with you. There is an intersection of ethics culture and leadership in Australia; in the UK they look to the European Union to bring about a change in behaviours. So, the standards laid down by the European Union and in India there is tolerance and they are really touching upon the hearts of the people ethical behaviour is more linked to you know convincing people to follow their hearts and tolerating the behaviour around them.

So, more emphasis on pluralism and that is all we have time for in this lecture. I know I rushed through some things in the interest of time and compressed a lot of material here, but in the next lecture we will wind up the discussion on corporate governance and CSR. And we will end up, we will end this module in the next class.

So, thank you very much for listening.