



CORPORATE GOVERNANCE AS A SOLUTION FOR CORRUPTION IN THE PRIVATE SECTOR

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Abstract

Corruption in its broader context has been identified and mentioned in the early years. However, the current concerns over corporate corruption have gained a global attention only recently. Following the collapses of the high profiled corporations such as Enron and Worldcom and the scandals behind the bankruptcy of those organizations, it drew a huge interest of the governments and the public towards finding the reasons for those economic disasters. Although corruption had been a concern in all parts of the world and in every sector of the society, it is deeply rooted in all those sectors across the globe. However the recent trends of corporate society towards building a better corporate citizenship encourage the concepts of transparency, integrity, good governance and CSR. Consequently it is contributing to one of the main solutions highlighted in this work for corruption which is, countermeasures within the corporation. The second and more integrated solution is regulatory and institutional countermeasures. Different nations approach differently in adopting a system that meets the interests of stakeholders as well as the interests of the whole society at large. Law makers are obliged to review the traditional trade laws to keep up with the dynamic and evolving corporate environment. Hence, the solution for corporate corruption is not the corporate governance codes or laws and regulation alone, rather it requires an integrated system; a framework which within the independent authorities or governing bodies work together with the various actors in the corporate world.

Keywords: corporate governance, corruption, private sector, corporate corruption.

1. Introduction

Corruption has long been identified mostly as a concern in the public sector management. The concerning NGOs and independent oversight mechanisms concentrated their interests mostly on the public officials' corruption. According to Transparency International, bribery and corruption in the value chain are a persistent challenge and more destructive than previously understood (Transparency International 2009).

The unethical or fraudulent actions in businesses have always been rationalized in a way that the people involved are made to believe it's justifiable. The profit that they claim such activities bring to the organization neutralizes any regrets or negative feelings that emanate from participating in such activities.

However, for the last decade the influence of corporate scandals on the reputation of the companies has grown large. And the shortcoming of existing corporate policies and regulations resulting in fraudulent and unethical actions caused the bankruptcy of top level business establishments in the United States, Europe and other countries. These events forced the governments and regulatory bodies to revise the laws, regulations and policies to minimize the possibility of misconduct, and set ways to have the responsible person accountable.

Since the corruption challenges are becoming much broader than previously understood the concept of bribing is only one small part of the problem. The other dimensions of corruption goes deep into nepotism and corruption in private business interactions, as well as corruption in the marketplace which undermines fair competition, fair prices and efficiency worldwide. These are more difficult to police and legislate for than direct corrupt payments of traditional concept of bribery. All forms of those corruption activities take advantage of shortcomings in transparency, internal governance and oversight. Therefore the drivers of corruption will be addressed in this work.

This review is not focused to cover the corruption in its all aspects, rather the problem will be considered in the context of corporate governance and its role in fighting corruption in the private sector. The study will highlight the concept of corruption in its broad context and deeper in a corporate context. It also focuses on corruption and its relationship with the corporate governance systems.

2. Corruption In A Corporate Context

The general concept of corruption is the abuse of entrusted power for private gain (transparency international 2009). This could be applicable in any field. Thus, in order to identify the true nature of corruption in the corporate context and its characteristics in this manner, it needs to be more specified. Corporate corruption can be categorized into three aspects; corruption that takes place between the public and private sector, corruption within the private sector itself and the corruption that occurs between the private sector and individuals or groups (Hirsch, Watson 2010). This excludes the corruption that occurs within the public sector and that occurs between public sector and other third party individuals or groups.

3. Corruption in the Private Sector; Why Does It Matter!

Executives and other actors in the corporate field may see nothing wrong in engaging in corrupt activities that benefit the business (Carr, Outhwaite 2011). They might consider doing some good for the society in the name of CSR later on.

The seemingly simple practices of misconduct in the private sector have significant costs for the owners or stakeholders of the firms as well as for the society. First of all, if caught doing, they are punishable under the criminal law. In addition to that there are financial and reputational implications. Five multinational companies (Siemens, Pirelli, BICC, Marubeni, and tomen) were banned by the government of Singapore from bidding on any government projects for five years following the conviction of their consultant for paying bribes for utilities construction contracts (National University of Singapore 2005).

The infamous and high-profiled collapses of some of the largest corporations during 2001 and 2002 has sparked the public and political interest in the regulation of corporate governance and practices, namely the collapses of Enron Corporation and WorldCom of USA. The Enron whistleblower, Sherron Watkins, in her evidence submitted at the investigation, highlighted that she did not approach her two managers with her concerns on the grounds that this would be “fruitless” and might cost her job (Drew 2010).

With such experiences of past events it is evident that corruption distorts distribution of income, discourages investments, causes inefficiencies and the waste of resources and creates unrealistic demand and violates the true competition in the market (Ertimi and Saeh 2013).

4. Corporate Governance (Cg) and Corruption; History and the Relationship between Them

The OECD description of CG structure as specifying, the distribution of rights, powers and responsibilities among owners, board members, executives, shareholders and other stakeholders of the corporation. While it sets out the relationship between those participants, it also constitutes the rules and procedures and policies for steering the business and making decisions on corporate affairs (OECD 2010).

In a corporate context the principal-agent concept might not always be the basis on which the managers act. The idea that directors must act in the best interests of the company (throughout its lifetime) might not comply with the current interests of its present shareholders. The management in a corporate context needs to take into account broader considerations such as the interests of future shareholders (Noonan, Watson, 2007). Thus a good corporate governance practice is not limited to the relationship and distribution of power within present stakeholders. Most importantly It provides a framework for decision making for the best interest of the company in a sustainable manner (Hirsch , Watson 2010).

While looking at the history of corruption and corporate governance, corruption as a concept can be traced back to early ages. The Babylonian King Hammurabi at around 1795-1750 BC mentioned bribery in his Code of Law (Rex Pay 2000). However corruption as a global context has been focused on very recently. In 1988 England formed its Serious Fraud Office, while New Zealand; one of the best countries in terms of corruption according to Transparency International’s “Corruption Perceptions Index (1995 to 2013) followed the example of England only in 1990. The United States made their “Corporate Corruption Bill” also known as Sarbanes-Oxley Act in 2002 (The White House 2002). In 2003 The United Nations adopted a Convention against Corruption.

It is not by accident that the above mentioned laws and conventions were adopted following the collapses of several large corporations in the United States and Europe during late 1990s and early 2000s.

5. Principal-Agent Concept of Managing Business; One of the Biggest Challenges for a Sound Corporate Governance

The principal-agent problem occurs when there is a separation between those who own the firm (the principals) and those who control or manage it (the agents) (National University of Singapore 2005). While the owners’ interests are more on maximizing the return on their investments in the long run, the managers’ incentive might be different. The manager (agent) in this case might consider a temporary benefit for him at the cost of a potential risk to the owners. Sometimes the risk for owners or the company itself might not be very obvious. For example, in the cases of bribery by the agent for winning a bid for the company, the owner sees the manager as successful and sometimes resulting in compensation. But the firm may be held criminally liable for the bribery involvement in the future.

According to this view, firms with no shareholder having any adequate incentive to closely monitor the management displays poorer performance than those firms whose structures are characterized by greater concentration of ownership (Jianguo, Dar-Hsin, Huimin 2007).

However the agency problems occurring in western countries are less common in Asian companies. It is because corporate governance in business organizations and their boards is heavily influenced by the owning and controlling shareholders and acts as ‘rubber stamps’ of the dominant owners or principals (Young et al. 2008).

6. Whistleblowers; A Stimulus Towards Corporate Governance Laws and Regulations

International Labor Organization defines whistle blowing as “The reporting by employees or former employees of illegal, irregular, dangerous or unethical practices by employers” (ILO 2005). In a corporate context, (Figg 2000) defined

whistle blowing as a disclosure of information by an employee or contractor who alleges willful misconduct carried out by an individual or group of individuals within an organization.

During the recent years whistle blowing has gained global attention with WikiLeaks. And the following reactions by the countries such as US, everyone believed whistleblower laws are mandatory to protect and encourage such voluntary policing of misconduct in the interest of the whole human kind. Even though whistleblowers are favored by almost everyone, the small minority that hates whistleblowing is the minority that holds the majority of power and authority. Hence many nations still do not have formal whistle blower laws (Goel, Nelson 2013)

The failure of Enron's auditors to "blow the whistle" on Enron's executives underlines the need, not only for reform of the accountancy profession but also for there to be alternative mechanisms in place through which employees and auditors can communicate concerns over malpractice, bribery or corruption without fear of reprisal

The following table shows the contribution of whistleblowers in detecting the corruption or the economic crimes in the US.

Table 1: Detection of economic crime in the US	
Source of detection	Percentage (%)
Investigation and audits	50
Whistleblowers	36
Other sources	14
Total	100

Source: Pwc Survey, SmartPros Ltd. (2003)

The table shows that whistleblowers as a source of detection for economic crimes contribute a 36% which is the second highest contributor after the investigation and audits which are highly costly.

7. Discussion

The whistleblowers' concern over the threats they are facing needs an answer. Most of the countries develop codes or policies that the corporate establishments should follow. But those are most of the time evadable. This makes the preferred solution for encouraging and protecting whistleblowers and the most common reactions for the financial and economic crises by the nations are developing laws and regulations with severe punishments for those who break them. Those laws, regulations or codes are the backbone of Corporate Governance. Different nations have different approaches in monitoring the implementation of such corporate governance codes by the firms. Whatever the method is, corporate governance codes has topped the parameters by which the private sector can be evaluated in terms of their good or bad corporate citizenship.

The solution for corporate corruption comes in two equally important forms; Internal and External. The internal controls include but are not limited to the examples such as authorizations and documentation to substantiate expenditure, separation of responsibilities, mandatory review by senior employees of payments in excess of a specified amount, routine reviews of cash books and ledgers, regular internal audit. The external controls cannot be limited to laws and regulations alone. But there must be an external regulatory body or a reporting system that oversees the performance of the organizations. It must be obliged to monitor the accurate recording, classification and reporting of transactions in financial statements which are in full compliance with disclosure standards, annual external audits and externally or internally developed code of conduct is crucial.

8. Conclusion

In the private sector management the duty of directors and managers are not limited to the satisfaction of current stakeholders. But they also have a corporate obligation that requires protecting the interests of any future stakeholders, which might not always be the same. This great challenge to the management can only be solved by a set of integrated corporate governance framework which comes together with necessary laws and regulations. This framework also needs an independent parental body which oversees the implementation of those laws and regulation and which has the authority to take necessary steps towards who evades those rules and regulations. Moreover Corporate Governance alone cannot be the only solution for corruption or misconduct in the private sector. But it can be the foundation on which the corporate society builds its relationship between all actors in the global corporate world. In a globalized world what happens to a corporation in the Europe might affect a country in the far east of Asia. This puts every single participant in the corporate world at risk. Poor corporate governance constitutes the principal source of corrupt behavior in a corporation, thus adopting a sound corporate governance system could be the foundation for fighting misconduct and corrupt activities in the corporate world.

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