

Our Past, Present and Future: The Ethical Evolution of Corporate Governance *By H. Stephen Grace, Jr., Ph.D.*

The number of large-scale corporate collapses in recent years has been startling; and while we thought they were confined to this country, they have now spread well beyond our borders. Sadly, right in the middle of these problems are the firm's senior financial officers, bringing to light the role of ethics, or lack thereof, in the evolution of corporate governance.

Ethics are important. They lie at the core of personal, political and corporate governance. However, as history demonstrates, emphasis on ethical behavior and "tone at the top" alone will not insure effective corporate governance.

Our past

Acts of personal governance are as old as time. Thanks to this rich history, we now have more than 5,000 years of spiritual and philosophical text to help guide our personal governance endeavors. However, as true and reliable as these resources may seem, we know that breakdowns in human behavior have continued to occur. The result - we cannot simply rely on ethical codes and moral persuasion to carry the day.

Supplementary to acts of personal governance are those of a more political nature. For the most part, political governance has been a history of kings, monarchs and dictators. This is not surprising, however, considering these methods conceptually represent the most effective, efficient forms of political governance. Yet, throughout history, many of these structures struggled, confirming the words of Lord Acton regarding governance structures that permit an excessive consolidation of power, "Power tends to corrupt and absolute power corrupts absolutely."

Eventually, political governance gave rise to democracy, dramatically changing the course of history. Undoubtedly the best form of government to date, in spite of being onerous and time consuming, democracy is an effective set of checks and balances, emphasizing the rights of the governed, and encouraging ethical behavior.

Our present

The lessons learned from studying thousands of years of personal and political governance form a basis for addressing the challenge of insuring effective corporate governance. Our fundamental belief is that corporate governance is either win-win or lose-lose, and not just for the participants, but for all of society. Very simply, good corporate governance leads to a bigger pie, more to be shared by all participants. Poor governance results in the exact opposite.

Effective corporate governance involves the dynamic definition of the roles and responsibilities of each and every participant in a transparent manner that optimizes potential synergies, rather than just shifting power from one participant to another. Effective governance incorporates robust checks and balances and is characterized by transparency.

At the heart of this concept is the Oversight and Control System (OCS). This system and its subsystems aid both the board and management in addressing their responsibilities. The board and management must understand and address the challenges of measurement - the ambiguities of accounting, financial and non-financial measurement. Effective management oversight and monitoring by the board of operations requires not only the P & L and the balance sheet, but the tracking of cash flows and key value drivers. Simultaneously, management and the board must also understand and oversee the enterprise-wide risk management program in place.

Our future

I believe strongly that the overwhelming majority of members of boards, senior management and internal and external auditors have made a resolution to live and work ethically. They have integrity and they believe in codes of ethics. Now, it is up to us to create systems of checks and balances that encourage and support these individuals.

My belief is that, as the corporate governance evolution continues, we will see effective corporate governance cultures emerge. They will be built on a strong ethical foundation, but not rely on ethics alone. They will incorporate robust checks and balances which address the challenges of measurement, and they will be characterized by transparency.

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