

CORPORATE GOVERNANCE RELATION WITH CORPORATE SUSTAINABILITY

PhD candidate Mr. ISSAM MF SALTAJI
Academy of Economic Studies, Bucharest, Romania
createmyworld@mail.ru

Abstract:

Sustainability is targeted in this article to be integrated with corporate governance presenting its importance in business world not as obligation, but as a tool be adopted. Economic challenges push companies to think twice before making decisions. Corporate governance is a success key for companies through improving performance and gain mistrust of investors serving business sustainability. Objectives direction has been changed from concentrating on shareholders' benefits to maintain sustainability in general perspective. Sustainable economy becomes main feature of business world needs requiring strong militarization of all companies' resources. That has been interrupted by climate change and financial crisis setting an urgent need from managements to adopt strongly sustainability and governance principles. Governance functions cannot be completed without sustainability strategy; both are affected by social, environmental, and economic aspects. That what article tries to present through collecting prime resources of leading companies in corporate governance and sustainability, and secondary data from academic researches supporting that by empirical study to proof that companies have been saved from collapsing by adopting corporate governance responsibility and sustainability principles during financial crisis.

Key words: BAT, Corporate Governance, Corporate sustainability, Nokia, Sustainability.

JEL classification: G38, Q 56

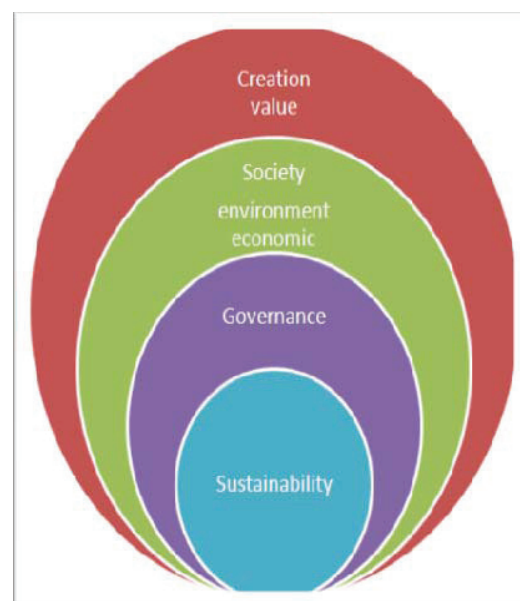
Introduction

“Coming generations will never forget our current steps on this universal and earth”. Significantly, sempiternity is an important character of characteristics of economic body, in law's eyes is treated separately as legal entity to hold properties and liabilities. Consistently, each company has the intention to continue

its activities in long-term. That is directly related to its services and products with ensuring minimum damage of nature for its activities that means having sempiternity is strongly related with sustainability. Climate change has putted heavy duties on business world asking for huge investments in reducing pollution and keeping global warming in acceptable levels. These investments request integrating technologies and supply chain to highlight the need of redirecting companies' resources to serve sustainability. The reputation is an important asset for a company consist of corporate citizenship (56%) product quality (40%), and business fundamentals (34%) - Millennium Poll, *"It takes 20 years to build a reputation, and five minutes to ruin it"* (Warreb Buffet, Chairman, Berkshire Hathaway) That means good governance by monitoring board performance, sustainable business, corporate citizenship, corporate social responsibility and socially responsible investment, is integrated with sustainability. Corporate governance generations have been switched by time from focusing on legal issues and shareholders to engage with stakeholders and creating new accounting models to reach mature level like nowadays under title "Governance for Sustainability". Financial scandals starting with 2008 have led to mobilizing capital between demotic markets in order to determine economical opportunities for growth synchronous with adopting corporate governance as a management tool, and sustainability as a business strategy. Sustained and sustain refer to sustainability meaning prolonged, perpetual and steady (Collins Thesaurus; Oxford dictionary), corporate sustainability integrates with sustainable development (Jonathan P.Doh & Peter Tashman 2012).

Corporate governance and sustainability

Nowadays, sustainability is treated seriously by companies to affect company culture and society. Significant sustainable properties are presented in social and environmental responsibilities and economic growth as well, and these properties are working in union. The main object of a company is profit, which cannot achieve without responsibilities. Therefore, sustainability presents the possibility of sustaining life-quality maintained for next generations through transferring responsibilities of sustaining life-quality between generations. That requires



continuously developing of sustainability. Sustainability definitions are related to used approach; by strategy approach sustainability is a strategy used to achieve company's objective, and currently by board approach is used to present the integration of society and environment in business (Hart; 1995, Shrivastava; 1996). Academically, corporate governance is defined as management and control system used by companies (Kavalir, 2005). Also governance is a process responds to stakeholders' interests (Neubauer & Demb, 1992). Thus, corporate governance is considered as a significant element of universal set of sustainability development. Sustainability and governance are terms of same pool, have generated in same period as consequences of different conflicts and scandals. In the middle of nineties (1990's) these terms were tied up in professional reports related to societal changes with granting perpetual by law caused by transferring corporations from financial activities to non-financial activities. The central part of strategy – sustainability is economic, society, environment and governance affecting daily operations to make business successful. That creates a value for a company especially for its shareholder “value creation” presents an important function of governance. Exchange relationship takes place between society, environment, economic and governance to affect general performance by individual performances of each one (Salo; 2008, Horvathova; 2010). As result, not any more companies can ignore social, economic and environmental impacts on decision process to maintain sustainability for all; company, society and environment.

Corporate Governance and Corporate Sustainability

Aras and Crowther presented in their book “Developments in Corporate Governance and Responsibility, 2012” that sustainability is considered as a citizens' presenter in government, business and society. Many sustainability aspects might be reflecting social, economic and environmental sustainability with other options to be attached such as governance or management of supply-chain (Brundt-land report). Stakeholders' exercises are equally increased not because of their own interests, but it is an interest of sustainability in long-term. The world commission report on Environment and Development of United Station introduced the concept of sustainability in eighty of last century (Brundt-land Report 1987). Sustainable development is described as a process of changes in resources development, investing direction, technologic orientation development, and changes of instruments and protecting ecosphere of human activities. This development can be in technological development and social activities

development essaying current needs of generation without damage the possibility of meeting the needs of next generations. Sustainable development is not limited by government regulations and policies, industrial activities are obviously having important role (World Commission Report). Companies are aimed by sustainable development in setting up their areas for economical, social and environmental performance. Also it creates a common social target for companies, civil organizations and governments to unitize their efforts in environmental and social sustainability with being aware that sustainable development alone does not have sense for companies. Arguments are increased dramatically when the corporate sustainability relationship with sustainable development takes place to leave the door open to big discussions about corporate social responsibilities and theories of stakeholder (Wilson 2003). Strategies and practices are covered through corporate sustainability helping to meet stakeholders' needs such as protection and supporting. In meantime, it increases human and natural resources requested in future. The World community sets up essential principles for sustainable development:

- ✓ Equity intergeneration: sustain natural resources for next generation.
- ✓ Sustainable use: using natural resources in a careful manner with minimum or without any damage for these resources.
- ✓ Equitable use or intergenerational equity: using natural resources cannot be on account on other counterpart and without harming others.
- ✓ Integration: impacting between economic actions and environmental aspects.

Corporate sustainability has been pointed as substituted theory to profit-maximization and traditional growth theories under conditions of brining benefits and justice to society and protection to environment. Significant attention on economic development has been occurred through recognizing coincident profitability and growth for a company to present new approach for long-term to increase covered share value possibilities, and risk managing comes from social, economic and environmental developments. Business practices are surrounded by environmental and social considerations meaning that corporate sustainability covers these practices and strategies to: help essaying stakeholders' needs and support them, increase and protect human and natural resources, in order to be used in future by next generations. Maximization shareholders' value is achieved

through leading business strategies and management models to control market's possibility for products and services sustainability, and to reduce cost and risk sustainability – minimizing cost and risk (Michael E. Porter & Clayton M. Christensen 2006). Corporate sustainability definitions: Kai Hockerts and Thomas Dyllick: corporate sustainability essays stakeholders' needs directly and / or indirectly without affecting essaying future stakeholders' needs. Australian government: corporate sustainability covers these practices and strategies help to essay stakeholders' needs today, although looking to ensure, protect and support humans and natural resources, which will be need it in future. Dow Jones defined: corporate sustainability is that approach used in business to create shareholders' value for long-term through covering opportunities and risk management deducing from social, economic and environmental changes. The Journal of Environmental Strategy defined: corporate sustainability is that capacity to assert economic successfulness under environmental and social responsibilities considerations. Accountability definition is that capacity of firm to continue activities with considering activities impacts on social and human capitals. Summarizing all of these definitions, we conclude that corporate sustainability tries to assimilate social and environmental dimensions into business functions. Practically, corporate sustainability is an approach goes to pragmatic issues presented in measuring performance on natural, social and environmental dimensions, and to integrate social and natural values in corporate accounting.

The comprehensive definition of corporate sustainability is that business approach creates long-term value for shareholders by sweeping up opportunities and risk management of social, economic and environmental developments (Dow Jones Sustainability Indexes). In meantime, corporate sustainability discerns important profitability and growth of a company, which requires engaging with social, economic and environmental developments. Evolutionarily, corporate social responsibility and corporate sustainability are different concepts; corporate social responsibility is these obligations pressure management to make decisions engaged with social policies or take in account desirable actions in term of values and objectives of society. Social responsibility must be equal with legal and economic responsibilities enforced by law (Rebekah Smith; Ethics & Social Responsibility of Management); companies are looking to satisfy other obligations relevant to community where they are operating. In 1980 new approach of corporate social responsibility obligates companies to have a group of stakeholders – stakeholder

approach instead of simple shareholder approach, where efficient performance of stakeholder is achieving the objectives of the company (David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV 1.1; 1979). Even though, corporate social responsibility and corporate sustainability are afforded from different source and different developing theoretical routes to meet at the end proofing recent CSR definitions of international institutions. Corporate Social Responsibility is transparent and open practices based on ethics values, employees' rights, environmental and communities. CSR is designed to transfer largely corporate social responsibility to shareholders and to society as well. Sustainable development concept is transferred from macro level to micro level practiced in company's proportion. Companies are main resource of socio-economic system and keys of implementing sustainability in society. Therefore, the frame work can be divided into two subjects; corporate social responsibility and corporate sustainability without ignoring their relationship, simply governance responsibility is applicable way for sustainability objectives (Sustainability Index 2008)

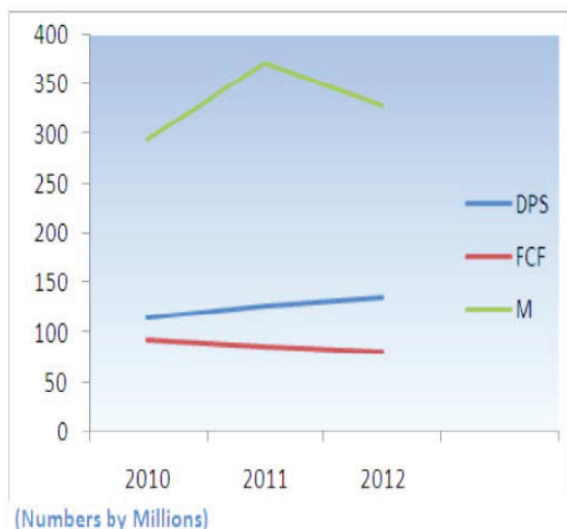
Empirical Study

Briefly, this study tries to proof pervious theoretic part through selecting two companies from different industrial are British American Tobacco and Nokia.

ABT: Proofing the relationship between corporate governance and sustainability is presented through corporate social investment. Corporate citizen has long term invest in charitable activities and community. The approach of CSI – corporate social invest is endless and ABT works to assert excellent relationship with community to be translated by continuing social investing even it is decreased in numbers as result of changing in accounting standards and financial crisis impact, but it is still valuable for community (13.7 m £ in 2011 to be 11.6 M £ in 2012).

Corporate governance is independent factor, and profit per-share and equity changes are variable factors with considering other factors are fixed. The formula is: **$f(G) = DPS + FCF + M$**

(G: corporate governance, DPS: profit per share, FCF: free cash-flow, M: market value of ordinary shares).



Dividends per share are continually increased in 2010 by 15%, 2011 by 11% and in 2012 by 7% that is generated by increasing operating profit and including adopting new strategies and developing governance application serving BAT goals to sustain earning per share and also to serve corporate sustainability. Free cash per share as ratio

of adjusting diluted EPS (%) are settable in the last three years in 2010 was 92% to be in 2011 by 86% (changed by -6.52%), in 2012 by 81% (changed by 5.81%). Market value of ordinary shares was 294.4 M in 2010, 370.4 M in 2011 (changed by +25.81) to be 328.3 M in 2012 (changed by -11.36).

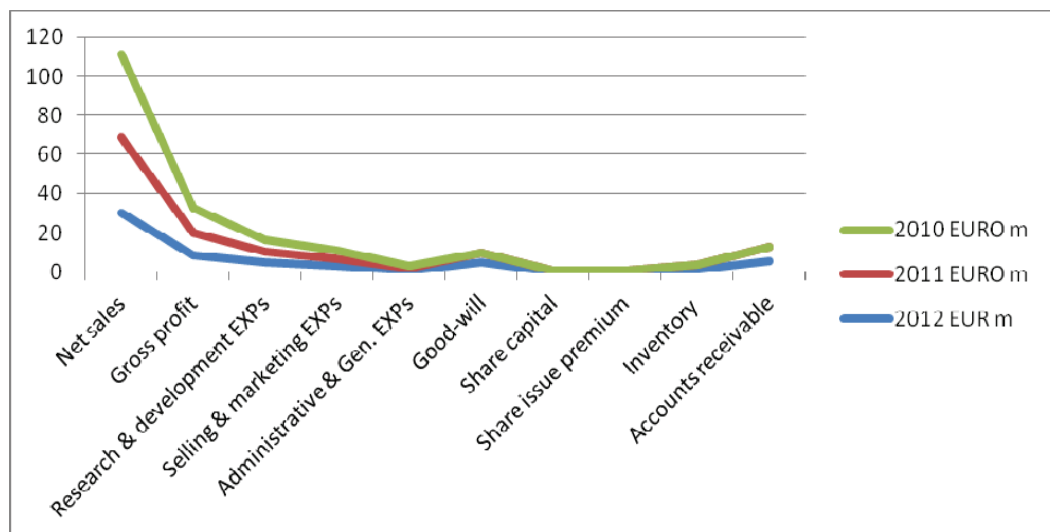
The logical relationship between dividends and free cash tells us that the changes in credit policy in 2011 and developing governance system of BAT are behind continuing profit growth even though fair-value adopting causes decreasing financial items. Soon, the net profit of ABT will keep increasing but free cash will sustain in average medium. Connecting that with ABT sustainability agenda we will find that future performance of ABT depends on stakeholders' feedback cooperating in share value creation for all stakeholders including shareholders. The agenda is that integration between delivering strategy and focusing on factors impacts: Harm reduction, Marketplace, Environment, supply chain and people and culture with full respect of OECD principles of corporate governance (1999, revised 2004). BAT is included in Europe Index and Dow Jones Sustainability World



for the next eleven years, and it was ranked 5th out 127 European corporations for including biodiversity impacts in its reports.

Nokia - annual report 2012:

Items	2012 EUR m	2011 EURO m	2010 EURO m
Net sales	30.176	38.659	42.446
Gross profit	8.390	11.359	12.990
Research & development EXPs	4.782	5.584	5.844
Selling & marketing EXPs	3.205	3.769	3.856
Administrative & Gen. EXPs	0.959	1.085	1.039
Good-will	4.876	4.838	
Share capital	246	246	
Share issue premium	446	362	
Inventory	1.538	2.330	
Accounts receivable	5.551	7.181	



The decreasing in net sales by 8% in 2010-2011 and by 21.94 in 2011-2012 reflects on net profits. That happened during adopting good governance practices reflecting on the number of shareholders which is increased through the last three

years by 0.03% in 2010-2011 and 0.24% in 2011-2012 that is great growth of telecom companies in financial crisis. There are changes in strategies as well shown in decreasing inventory account by 33.99% in 2012 and increasing accounts receivable by 22.69% in 2012. Good-will is increased by 0.78% in 2011-2012 that was without changes in share capital with increasing share issue premium by 23.20% in 2012 (56% is by corporate citizens). Decreasing in research and development expense, selling marketing expense and administrative and general expense become through adopting corporate governance application and adopting corporate social responsibility integrated with sustainability. That is meeting with Nokia sustainability report to make sustainable products incorporate with best practices with society and environment to improve lives of people.

Conclusion

The current situation of business world requires from companies to adopt full set of corporate governance and sustainability. Before, tangible assets and financial reports were the main concern of a company to create value for its shareholders. Now intangible assets are higher than tangible assets as percent, and concentrating switches to non-financial reports and information affects bottom line. These changes come through implementing corporate governance and sustainability principles in a certain company. Moreover, that serves value creation of shareholders and for all stakeholders. The moral responsibilities of companies start to take place in business world through practicing corporate governance responsibilities and ensuring sustainability as a need for a company in first level. Corporate sustainability is affected by social and environment sustainability creating circle between each others.

Sustainability in dynamic environment needs effective corporate governance aiming companies to improve financial operations, to enjoy capital low-cost and to attract intelligent clients, suppliers, investors and partners. Corporate governance with stakeholder theories tries to solve conflicts of stakeholders' interests, not only internal issues are considered. Sustainability enforces companies to take more responsibility toward environment and community supporting corporate sustainability. Moreover corporate governance contents ethics codes and corporate responsibilities which are part in somehow of companies' vision and mission. Outputs quality of companies can be increased through this combine. Successful companies who implement even partially and indirectly corporate governance achieve financial stability and sustainability. Over

all ensure that sustainability is a strategic in long-term for companies requires a strong monitoring system presented in corporate governance. Sustainable activities of a company can reduce operating and non-operating expenses to provide competitive advantages during financial crisis. Increasing role of green party and non government organizations have been affected companies activities and strategies, but that is still not enough strong since all sustainable regulations does not have a strong provision to force countries and companies to adopt sustainability as business strategy. That is noticeable in United States of America and other industrial countries. Therefore, the experience of sustainability has different rates between countries asking concerned institutions to promote sustainability benefits and to increase related conferences to attract companies and to push them to act responsibly to all variables around the world like promoting Dow Jones Sustainability Index.

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