

Integrating Corporate Governance Into the Business School Curriculum: Some Simple Suggestions

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Abstract: A wide range of stakeholders, including leadership in the Association to Advance Collegiate Schools of Business International (AACSB) and writers for the *Wall Street Journal*, have called for increased emphasis on the topic of corporate governance in undergraduate business school curricula. These interested parties, along with myriad others, cite the litany of malfeasance discovered over the past decade in the operations and reporting of financial results within large multinational companies. These flawed managerial decisions have lead to significant economic consequences that can be traced, in large part, to corporate boards and management teams that lack a full understanding and appreciation for their important positions within the complex financial structures that form the foundation for the global economy. Indeed, this behavior is rooted in an abysmal lack of knowledge, an educational failing that can be at least partly attributed to business school graduates that have not been sufficiently educated in the principles, fundamentals, and applications of corporate governance in day-to-day operations. This paper has two objectives. First, it offers business school faculty from all functional areas a brief overview and framework for understanding the evolving cross-functional topic of corporate governance. Second, a call is made for business faculty to accept the challenge by incorporating essential elements of corporate governance into their business courses. This latter objective is seeded by some suggestions for accomplishing this task.

Introduction

Following the recent financial scandals at Arthur Anderson, Bernard L. Madoff Investment Securities LLC, Enron, Lehman Brothers, Tyco International, and WorldCom and the global economic downturn, the phrase “corporate governance” is garnering increased attention. However, a single, comprehensive definition of corporate governance, one that satisfies the needs of every economic entity situated in all global geographic locations, does not exist. Indeed, the factors that determine and define corporate governance vary by country and organizational structure making such a comprehensive definition impossible and the issue more complex. While the United Kingdom Corporate Governance Code and the South Africa King Report III offer guidance in a ‘comply or explain’ approach, the United States (US) generally mandates certain aspects of corporate governance through legislation such as The Sarbanes Oxley Act of 2002 (SOX) and the Federal Sentencing Guidelines for Organizations.

Despite these differences a quick review of university-level textbooks, business press articles, and other media sources yields a list of concepts common to the understanding of corporate governance. These common concepts include developing a long-term perspective on decision making, creating shareholder value and positive financial results, aligning managerial actions with stakeholder interests, complying with applicable laws and regulations, and electing an engaged, active board of directors or equivalent body. Wide-spread agreement on these concepts permits discussion of corporate governance, leading to a framework that can be modified to fit the specific needs of an array of entity-country combinations.

Corporate governance includes the processes that guide and control an organization in a manner that permits the enterprise to satisfy its responsibilities as a citizen. These processes cut across all facets of business operations including accounting, economics, finance, management and strategy (Bisoux, 2004). For this reason, the topic is truly cross-functional and can – and should – be addressed within the context of existing undergraduate business programs without the need for development of a free-standing course. For purposes of this paper, corporate governance refers to “The process affected by a set of legislative, regulatory, legal, market mechanisms, listing standards, best practices, and efforts of all corporate governance participants, including the company’s directors, officers, auditors, legal counsel, and financial advisers, which creates a sustainable shareholder value, while protecting the interests of other stakeholders” (Rezaee, 2009, p. 30).

Several authors have argued that business schools’ failure to teach fundamental corporate governance concepts is a primary factor in the recent financial scandals. Further, it is reasonable to assert that such a continued omission will likely result in future scandals of this type (Jacobs, 2009). With respect to the current state of education surrounding the topic of corporate governance, as reported by AACSB, some elements of governance are mentioned in a number of business school curriculums; however, few business schools have specifically designed curricula that overtly discuss each element (AACSB International, 2004). “Knowing the principles and practices of sound, responsible corporate governance can also be an important deterrent to unethical behavior. Moreover, understanding the complex interdependencies between corporate governance and other institutions, such as stock exchanges and regulatory bodies, can be an important factor in managing risk and reputation” (AACSB International, 2004). The need to address this existing educational failure is certain; the

opportunity to deter or limit potential negative, future economic consequences is evident; and the means to remedy this educational omission are available – all that is needed is the courage to do so. This paper attempts to provide a catalyst in that regard.

Educational Model of Corporate Governance

AACSB recommendations address this important topic with a specific suggestion that business schools present students with a firm background in corporate governance. Topics may include, but not be limited to, the roles and responsibilities of management groups such as the board of directors, audit committee members, independent public accountants, and any other employees who operate at the intersection of a corporate entity and the various regulatory bodies that oversee corporate activities. Business students should gain at least a working knowledge, and preferably a more substantive understanding, of the concept and workings of effective internal control plans; the components of useful codes of conduct; the elements of successful corporate compliance programs; and a refined understanding and appreciation for legal regulations and recommendations that form a global compliance framework, such as SOX (AACSB International, 2004).

This paper explores the option of incorporating corporate governance topics into the core business curriculum required of each US-educated business student (such as principles of accounting, economics, finance, management, and strategy). This pedagogical approach suggests that the concepts of corporate governance would be introduced to students early in their studies through their first core business courses - principles of accounting and economics. This introduction would provide the foundation for expanding the topic in subsequent core courses offered in their junior level such as finance and management courses. Finally, student could assemble all of their knowledge of corporate governance and apply the concepts through case studies within a senior-level strategy course. This paper proceeds with a discussion of how such an interdisciplinary approach could be implemented across the identified core subject areas. This discussion is summarized in Table 1.

Accounting and Economics

All business students, regardless of their major area of study, should be encouraged to develop a solid understanding of the basic concepts of corporate governance. Typically our students are introduced to the study of business through course offerings in the principles of accounting and economics. At this time, they should be exposed to basic organizational forms (small business as well as corporate). The need for governance and the impact of these respective forms on the subject matter may be different, but the fundamentals exist regardless of the business form. As the emphasis in business core courses tends to be directed to a more formal business structure, the discussion that follows will focus on corporate entities.

Table 1: Summary of existing and suggestions for additional coverage of corporate governance in the core business school curriculum

<i>Discipline</i>	<i>Current Corporate Governance Coverage</i>	<i>Suggestions for Additional Corporate Governance Discussion</i>
Accounting	<ul style="list-style-type: none"> Basic organizational structure Corporate ownership & stockholder equity Financial reporting requirements 	<ul style="list-style-type: none"> Fiduciary responsibility of board of directors & managers to shareholders Role of the board and managers in preparing and representing the company's financial position More emphasis on corporate governance in conjunction with corporate ownership Role of SEC and other regulatory bodies in corporate governance
Economics	<ul style="list-style-type: none"> Relationship between corporate form and capitalist economy 	<ul style="list-style-type: none"> Importance of corporations complying with legal and regulatory requirements to ensure that economic system function as intended
Finance	<ul style="list-style-type: none"> Content of financial reports Management effectiveness Aligning corporate and shareholder objectives 	<ul style="list-style-type: none"> Internal control processes and procedures
Management	<ul style="list-style-type: none"> Agency theory Board of directors composition Stakeholder focus Compensation 	<ul style="list-style-type: none"> Active vs. passive boards of directors Compensation packages that encourage long-term decision-making
Strategy	<ul style="list-style-type: none"> Internal and external governance mechanisms Relationship between financial auditors, board of directors, and managers 	<ul style="list-style-type: none"> Balanced scorecard as an internal governance mechanism

A large, publicly-traded corporation has absentee owners. More specifically, a corporation is owned by shareholders who are generally not involved in the day-to-day management of the entity. The shareholders elect a board of directors to represent their interests and the board of directors hires managers to stand for their interests. It is presumed that both the board of directors and the managers understand their fiduciary responsibility to shareholders. This presumption is fundamental to corporate governance. It can be very successfully introduced within both the accounting and economics classes. In accounting, the subject of corporate ownership is discussed in conjunction with stockholder's equity. A little

emphasis on corporate governance would serve to clarify this subject while not consuming a significant amount of time. In economics, the discussion of capitalism would provide an effective time for discussing the corporate form and its major role in such a financial paradigm. More importantly, this role cannot be fulfilled if the corporation does not play by the rules. The success of capitalism relies upon such an outcome.

On a recurring basis (i.e., quarterly and yearly), corporate management must prepare financial statements and other important disclosures for timely filing with the Securities and Exchange Commission (SEC). This government entity was created by the Security Act of 1933 and is responsible for overseeing the efficient allocation of capital in the US. A discussion of this regulatory relationship is a component of the principles of accounting course. Failure to comply with SEC regulations can lead to de-listing of a stock, an outcome that clearly does not benefit anyone associated with a company that falls into this hole. This topic can be, but is not always, afforded expanded coverage in the principles of accounting. With a little effort, our students can be provided with a more complete understanding of the vital corporate governance role that is played by the SEC, or for that matter, any regulatory mechanism. And, such a discussion is certainly not outside the bounds of economics.

By the end of their sophomore year, through the knowledge obtained in accounting coursework, students possess the ability to read and understand the four primary financial statements: income statement, statement of retained earnings, balance sheet, and statement of cash flow. This knowledge can be encouraged through the use of actual financial statements throughout the principles of accounting course, as is becoming more and more common for such textbooks today. These statements are the output of a substantive corporate governance process and their role in securing the capital market cannot be minimized. It is difficult to argue, given recent events in the economy, that spending additional time on this topic is time wasted.

The role of an external auditor and the contents of the audit report, including the opinion paragraph, are presented and discussed in the principles of accounting sequence. Simply put, they serve as referees in the game of business. Specifically, an external auditor is an independent third party hired by the audit committee of the board of directors to perform a systematic and logical review of the corporation's financial statements as well as its internal controls. In this role, external auditors ultimately express an opinion regarding the fairness of the financial statements with respect to an objective measure and the operational worthiness of the control structure. Since the external auditor is engaged by an operating committee of the board of directors, s/he is responsible to and reports to the audit committee members and then onward to the board of directors. In turn, the board of directors offers these findings to the shareholders as evidence of their responsible discharge of the duties for which they have been retained. Additional time studying and understanding this symbiotic relationship is crucial for business students as they may play some of the many roles in this drama into the future including, at a minimum, that of a direct or indirect shareholder in such entities. The more they understand of this relationship, the better they will be able to perform as managers within a business context and stakeholders in the economy.

Finance and Management

Milton Freedman is often cited as having provided a clear and understandable definition and lens through which corporate responsibility to society can be defined and viewed by offering that "there is one and only one social responsibility of business – to use it resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud" (Friedman, 1970). This viewpoint certainly fits well with and may have played a role in the discussion and debate that ultimately lead to the passage of SOX.

During times of economic crisis, corporate governance always becomes a topic of high concern and changes to the regulatory environment frequently ensue. In response to the corporate scandals (primarily based in accounting failures) that occurred between 2000 and 2002, the US Congress passed SOX in order to provide a stronger framework under which managers and boards of directors of registered (publicly traded) companies in the US would operate. In essence, this legislation attempts to bring into agreement societal expectations and managerial actions in a manner that provides greater clarity in the financial marketplace. SOX represents more than a minor alteration to the business landscape – it is comprehensive and far-reaching, meaning that it is imperative that all future leaders understand why it exists and what requirements flow from its mandates. As such, it is clear that future managers—our current students—should have an understanding and appreciation for its role in corporate governance.

Corporate managers, not merely the corporation's accountants and record keepers, are responsible for the quarterly and annual reports filed with the SEC. Further, it must be clearly understood by all interested parties that these statements are the responsibility of management – not the external auditor. External auditors perform a specific function that does not include the preparation of these reports. SOX requires management to certify that the financial reports, such as 10K and 10Q documents, comply with SEC regulations and fairly present the financial position of the organization in all material regards. This managerial requirement was further clarified and expanded in direct response to the financial malfeasance and neglect that occurred in corporations such as Enron. In the case of Enron et. al., when the upper-level management team, such as the CEO and CFO, were asked to explain their financial accounting reports, they claimed that they were not accountants and did not understand the financial reporting environments of the organization sufficiently, thus they relied on others and should not be expected to know anything more. Their statements and their position on this important matter indicate an utter and complete lack of understanding of their role in this drama – an abandonment of their clear responsibilities to those who work in the firm and to its outside stakeholders.

All members of management, regardless of their managerial level, and boards of directors must understand the contents of the financial reports, the environment in which this data is collected and tabulated, and the overriding expectations that society members have for these documents. These topics are fundamental and can be addressed in both the finance and management core courses by expanding on the introductions made in accounting and economics, by enhancing current topical coverage to more completely address the issues, and through the addition of some new content that highlights these areas of concern.

A typical junior level finance course may discuss corporate governance from the perspective of increasing management effectiveness. Common topics include management compensation methods, hostile takeovers, monitoring the board of directors, interlocking boards of directors, stock options, and aligning corporate and shareholder objectives. Currently, little or no time is spent discussing the concept of internal control, a fundamental component of any effective and efficient financial reporting environment. As management is responsible for developing and maintaining internal control, it seems very reasonable to discuss this topic with all business students. Further, SOX requires management to assess and certify the internal controls of an organization on an annual basis. As future managers, our students will be required to function within this control environment and they will be held accountable for the outputs of the process. Certainly they have a vested interest in understanding the processes since they will ultimately be held accountable by stakeholders and regulatory authorities.

While many definitions for internal control exist, within the US the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) definition of internal control is the most widely respected. COSO defines internal control as "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (1) reliability in financial reporting, (2) compliance with applicable laws and regulations, and (3) effective and efficiency of operations" (COSO). Or, a simple definition which can provide a foundation for discussion is everything that the firm does to make sure that the things management wishes to happen, happen and the things they wish to not happen, do not happen. More formally, internal controls comprise a set of processes and procedures that management puts in place to provide reasonable assurance that the financial system has captured accurate and complete data.

While management is ultimately accountable for this control structure, everyone in the organization is an essential component in the development and operation of its core processes and it would certainly be best if everyone has a working knowledge, understanding, and appreciation for its existence and processes. Little if any substantive discussion of this critical topic is offered in either of the core courses in finance or management, which leaves a gap in the current education of our students. For finance classes, this void could be easily filled by adding coverage of internal controls to the topics previously identified as typical. And, importantly, the topic would fit well and likely enhance the discussion of the other topics.

Junior level management courses commonly include principles of management, operations management, organizational behavior, and human resource management. In general, corporate governance concepts are treated in less detail in these courses than in accounting and finance courses, despite the critical role of management in corporate governance. While fundamental governance concepts such as the roles and responsibilities of principals and agents, board composition, management's obligation to "control" the organization, stakeholder focus, and effective communication are key components of junior-level management courses, faculty can do more to draw explicit connections between these concepts, related issues in accounting and finance, and a strategic view of corporate governance.

Strategy

A course in strategic management is frequently a senior-level business course and sometimes the capstone course in a business administration degree program. As such, one of the key purposes of this course is to integrate the various functional areas of business and help students understand how organizations work as a whole. Corporate governance is a common topic in strategy courses. This makes sense if one assumes that top management and the board of directors are responsible for governing an organization. However, by saving detailed discussion of corporate governance until the capstone course, business faculty perpetuate the notion that lower-level employees are somehow less responsible for ensuring good corporate governance than their upper-management counterparts. Rather than introducing a cross-functional, integrated view of corporate governance in the capstone, perhaps business school curricula should reinforce and expand upon efforts in this direction undertaken in the junior-level courses. Case analysis provides a means for doing so.

Many strategic management courses use case analyses as teaching tools. Through case analysis students can compare the governance structures of various corporations and identify strong, effective governance practices. There are many corporate governance cases available to faculty that offer positive examples of corporate governance in action, as well as those more suited to an analysis of failures. At the senior level, the emphasis should be on the intersections between and among the various functions, stakeholders, and processes of the organization that contribute to good corporate citizenship, long-term financial success, and the associated good governance.

Conclusions

“The silos of that collectively deliver a management education have allowed corporate governance to slip between the cracks” (Karim, 2009, p. 253). Yet, “for many educators, teaching corporate governance may seem like attempting to assemble a very complex puzzle with many pieces still missing” (Bisoux, 2004, p. 28). In attempting to reconcile the need to teach governance concepts with the challenges of doing so, faculty may be wise to take a divide and conquer approach by segmenting treatment of corporate governance topics into most of the core business courses instead of relying on the capstone course to impart the importance and intricacies of effective governance. To that end, this paper has offered an overview of corporate governance as it currently fits into many business school curricula and suggested ways to improve the breadth and depth of coverage throughout the core curriculum. Academics have the opportunity to prepare our future business leaders “as they respond to a changing legal and compliance environment as well as complex, conflicting, and sometimes highly problematic interests and opportunities” (AACSB International, 2004, p. 9). Perhaps by expanding discussion of corporate governance and highlighting its multidisciplinary nature, faculty can seize this opportunity to positively influence the actions of today’s business students and tomorrow’s business leaders.

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