MODERN ORGANISATIONAL GOVERNANCE

DEVELOPMENTS IN CORPORATE GOVERNANCE AND RESPONSIBILITY

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MODERN ORGANISATIONAL GOVERNANCE

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PART I
THEORETICAL PERSPECTIVES

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MODERN ORGANISATIONAL GOVERNANCE: RE-EXAMINING GOVERNANCE: THE EVIDENCE

David Crowther and Shahla Seifi

ABSTRACT

In this chapter the operation of governance in a variety of contexts is shown to be both essential and problematic. Reasons involve contextual and cultural differences as well as different understandings. This led to a consideration of the desirability of global governance and the problems in regulating international markets. The relationship of governance with sustainability and with corporate social responsibility is also examined. In doing so this chapter provides an introduction to the volume and sets the scene for the other contributions.

Keywords: Corporate social responsibility; governance; risk management; sustainability; stewardship

INTRODUCTION

Although it is universally accepted that the concept of governance has existed as long as any form of human organisation, this concept is merely to encapsulate the means by which that organisation conducts itself. Recently however the

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term has come to the forefront of public attention and this is probably because of the problems of governance which have been revealed at both national level and in the economic sphere at the level of the corporation. Thus the financial collapse which led to the economic recession starting in 2008 can be firmly attributed to bad governance in the financial sector – something which has not yet been adequately addressed. Equally it led to the deliberate misreporting of oil reserves by the Shell company in 2004 (Cummins & Beasant, 2005). More recently it has led to the corruption problems in FIFA which led to the resignation of Joseph (Sepp) Blatter, the president and his heir apparent, Michel Platini, in 2005. Many more problems with governance have similarly been revealed in recent years. These problems have thus created concern with a re-examination of what exactly is meant by governance and more specifically just what are the features of good governance.

Many systems of governance exist but all systems are concerned primarily with managing organisations and therefore with the governing of associations and therefore with political authority, institutions and, ultimately, control. Governance in this particular sense implies formal political institutions that aim to coordinate and control interdependent social relations and that have the ability to enforce decisions. Increasingly however, in a globalised world, the term governance is being used to describe the regulation of interdependent relations in the absence of overarching political authority, such as in the international system, in other words governance and regulation are becoming treated as synonymous. Thus global governance can be considered as the management of global processes in the absence of form of global government. There are some international bodies which seek to address these issues and prominent among these are the United Nations and the World Trade Organisation. Each of these has met with mixed success in instituting some form of governance in international relations but are part of a recognition of the problem and attempt to address worldwide problems that go beyond the capacity of individual states to solve (Rosenau, 1999).

When the term global governance is used this does not of course imply that such a system actually exists, let alone that the effectiveness of its operations is accepted. It is merely to recognise that in this increasingly globalised world there is a need for some form of governance to deal with multinational and global issues. The term global governance therefore is a descriptive term, recognising the issue and referring to concrete cooperative problem-solving arrangements. These may be formal, taking the shape of laws or formally constituted institutions to manage collective affairs by a variety of actors – including states, intergovernmental organisations, non-governmental organisations (NGOs), other civil society actors, private sector organisations, pressure groups and individuals as governance applies to all organisations (e.g. FIFA as an example of an organisation with problems caused by poor governance) and not just to corporations and states. The system also includes of course informal (as in the case of practices or guidelines) or temporary units (as in the case of coalitions). Thus global governance can be considered to be the complex of formal and informal institutions, mechanisms, relationships and processes between and among states, markets, citizens and organisations, both inter- and non-governmental, through which collective interests on the global plane are articulated, rights and obligations are established and differences are mediated.

When we mention global governance this is not of course the same thing as world government: indeed it might be considered that such a system of global governance would not actually be necessary if there was such a thing as a world government, as the law would enact these requirements. Currently however the various state governments have a legitimate monopoly on the use of force – on the power of enforcement. Global governance therefore refers to the political interaction that is required to solve problems that affect more than one state or region when there is no power of enforcing compliance. Improved global problem-solving need not of course require the establishment of more powerful formal global institutions, but it would involve the creation of a consensus on norms and practices to be applied. Steps are of course underway to establish these norms and one example that is currently being established is the creation and improvement of global accountability mechanisms. In this respect, for example, the United Nations Global Compact[1] – described as the world's largest voluntary corporate responsibility initiative – brings together companies, national and international agencies, trades unions and other labour organisations and various organs of civil society to support universal environmental protection, human rights and social principles. Participation is entirely voluntary, and there is no enforcement of the principles by an outside regulatory body – indeed it is reasonable to argue that good governance needs no regulatory enforcement and it is only cultural problems which lead to lapses in governance. Companies adhere to these practices both because they make economic sense, and because their stakeholders, including their shareholders (most individuals and institutional investors) are concerned with these issues and this provides a mechanism whereby they can monitor the compliance of companies easily. Mechanisms such as the Global Compact can improve the ability of individuals and local communities to hold companies accountable.

Recent events have shown us that good governance is important in every sphere of the society whether it be the corporate environment or general society or the political environment: equally such events have shown us the problems which arise due to failures in governance. Good governance procedures can, for example, improve public faith and confidence in the political environment. When the resources are too limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society (Crowther & Seifi, 2010). Of course a concern with governance is at least as prevalent in the corporate world.

Governance is frequently considered for corporations but it applies equally to all forms of organisation and this is one of the themes of this book, to consider governance for all organisations. At the level of business good governance is essential for good corporate performance and one view of good corporate performance is that of stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial resources of the organisation so too would management of the organisation be concerned with the stewardship of environmental resources. The difference however is that environmental resources are mostly located externally to the organisation. Stewardship in this context therefore is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and utilising renewable resources, minimising pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future.

Ever since the financial and economic problems which started in 2007 a great deal of concern has been expressed all over the world about shortcomings in the systems of governance in operation and its reform has been the concern of business managers, academics and government officials all over the world, sadly with little positive result. Often companies' main target is to become global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firms' route to becoming global and what will be necessary to get global competitive power. There is more than one answer to this question and there are a variety of routes for a company to achieve this. Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government, the general public, etc., professional/service providers – and the corporate sector.

Of equal concern is the question of corporate social responsibility (CSR) – what this means and how it can be operationalized (Seifi & Crowther, 2012). Although there is an accepted link between good corporate governance and CSR, the relationship between the two is not clearly defined and understood. Thus many firms consider that their governance is adequate because they comply with The Combined Code on Corporate Governance, which came into effect in 2003. Of course all firms reporting on the London Stock Exchange are required to comply with this code, and so these firms are doing no more than meeting their regulatory obligations. Many companies regard corporate governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important investors/potential investors and to flag up that they have such governance policies. The more enlightened recognise that there is a clear link between governance and CSR and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders.

It is recognised that these are issues which are significant in all parts of the world and a lot of attention is devoted to this global understanding. Most analysis however is too simplistic to be helpful as it normally resolves itself into simple dualities: rules based versus principles based or Anglo-Saxon versus Continental. Our argument is that this is not helpful as the reality is far more complex. It cannot be understood without taking geographical, cultural and historical factors in to account to understand the similarities, differences and concerns relating to people of different parts of the world. The aim of this book is to redress this by asking subject experts from different parts of the world to explain the issues from their particular perspective.

One of the consequences of a concern with the actions of an organisation, and the consequences of those actions, has been an increasing concern with corporate governance. Corporate governance is therefore currently a fashionable concept over the world. It has gained tremendous importance in recent years. There is a considerable body of literature which considers the components of a good system of governance and a variety of frameworks exist or have been proposed. This book examines and evaluates these frameworks while also outlining the cultural context of systems of governance. Our argument in this book is that corporate governance is a complex issue which cannot be related to merely the Anglo-Saxon approach to business; indeed, as already stated, it cannot be understood without taking into account many cultural and contextual factors to understand the similarities, differences and concerns relating to people of different parts of the world.

One of the main issues, therefore, which has been of pressing concern for business managers, accountants and auditors, investment managers and government officials – again all over the world – is that of corporate governance. Probably since the mid-1980s, corporate governance has attracted a great deal of attention. Early impetus was provided by Anglo-American codes of good corporate governance.[2] Stimulated by institutional investors, other countries in the developed as well as in the emerging markets established an adapted version of these codes for their own companies. Supra-national authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles and recommendations. This type of self-regulation was chosen above a set of legal standards (Van den Berghe, 2001). After big corporate scandals corporate governance has become central to most companies. It is understandable that investors' protection has become a much more important issue for all financial markets after the tremendous firm failures and scandals. Investors are demanding that companies implement rigorous corporate governance principles to achieve better returns on their investment and to reduce agency costs. Most of the times investors are ready to pay more for companies to have good governance standards. Similarly a company's corporate governance report is one of the main tools for investor' decisions. Because of these reasons companies cannot ignore the pressure for good governance from shareholders, potential investors and other markets actors.

At the same time banking credit risk measurement regulations are requiring new rules for a company's credit evaluations. New international bank capital adequacy assessment methods (Basel II) necessitate that credit evaluation rules are elaborately concerned with operational risk which covers corporate governance principles. In this respect corporate governance will be one of the most important indicators for measuring risk. Another issue is related to firm credibility and riskiness. If the firm needs a high rating score then it will have to pay attention to corporate governance rules also. Credit rating agencies analyse corporate governance practices along with other corporate indicators. Even though corporate governance principles have always been important for getting good rating scores for large and publicly-held companies, they are also becoming much more important for investors, potential investors, creditors and governments. Because of all of these factors, corporate governance receives high priority on the agenda of policymakers, financial institutions, investors, companies and academics – or at least has a high profile if this does not necessarily translate into changes. This is one of the main indicators that the link between corporate governance and actual performance is still open for discussion. In the literature a number of studies have sought to investigate the relation between corporate governance mechanisms and performance (e.g. Agrawal & Knoeber, 1996; Millstein & MacAvoy, 2003) Most of the studies have showed mixed result without a clear cut relationship. Based on these results, we can say that corporate governance matters to a company's performance, market value and credibility, and therefore that company has to apply corporate governance principles. But most important point is that corporate governance is the only means for companies to achieve corporate goals and strategies. Therefore companies have to improve their strategy and effective route to implementation of governance principles. So companies have to investigate what their corporate governance policy and practice needs to be.

Since governance can be highly influential for firm performance, all organisations understand what are the corporate governance principles and how it will improve strategy to apply these principles. In practice there are four principles of good governance, which are:

transparency;
accountability;
responsibility,
fairness.

All these principles are related with the firm's CSR. Corporate governance principles therefore are important for a firm but the real issue is concerned with what corporate governance actually is.

Management can be interpreted as managing a firm for the purpose of creating and maintaining value for shareholders. Corporate governance procedures determine every aspect of the role for management of the firm and try to keep in balance and to develop control mechanisms to increase both shareholder value and the satisfaction of other stakeholders. In other words corporate governance is concerned with creating a balance between the economic and social goals of a company including such aspects as the efficient use of resources, accountability in the use of its power and the behaviour of the corporation in its social environment.

The definition and measurement of good corporate governance is still subject to debate. However, good corporate governance will address all these main points:

- creating sustainable value;
- ways of achieving the firm's goals;
- increasing shareholders' satisfaction;
- efficient and effective management;
- increasing credibility;
- ensuring efficient risk management;
- providing an early warning system against all risk;
- ensuring a responsive and accountable corporation;
- describing the role of a firm's units;
- developing control and internal auditing;
- keeping a balance between economic and social benefit;
- ensuring efficient use of resources;
- controlling performance;
- distributing responsibility fairly;
- producing all necessary information for stakeholders;
- keeping the board independent from management;
- facilitating sustainable performance.

As can be seen, all of these issues have many ramifications and ensuring their compliance must be thought of as a long-term procedure. However firms naturally expect some tangible benefit from good governance. So good governance offers some long-term benefit for firms, such as:

- increasing the firm's market value;
- increasing the firm's rating;
- increasing competitive power;
- attracting new investors, shareholders and more equity;
- more or higher credibility;
- enhancing flexible borrowing condition/facilities from financial institutions;
- decreasing credit interest rate and cost of capital;
- new investment opportunities;
- attracting better personnel/employees;
- reaching new markets.

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It can be seen that these long-term benefits are also directly related to the sustainability of a firm and the firm's success. We can evaluate corporate governance from different perspectives, such as that of the general economy, the company itself, private and institutional investors or banking and other financial institutions. Some research results show that the quality of the corporate governance system of an economy may be an important determinant of its competitive conditions (Fulghieri & Suominen, 2005). Authors suggest the existence of a reverse causality between corporate governance and competition and also examined the role of competition in the production of good corporate governance. Van den Berghe and Levrau (2003) on the other hand investigated from the perspective of companies, investors and banks. From the company's perspective, it can no longer ignore the pressure for good corporate governance from the investor community. Installing proper governance mechanisms may provide a company with a competitive advantage in attracting investors who are prepared to pay a premium for well-governed companies. From an investor's perspective, corporate governance has become an important factor in investment decisions as it is recognised to have an impact on the financial risks of their portfolios. Institutional investors put issues of corporate governance on a par with financial indicators when evaluating investment decisions. From the creditor's perspective, there is a plea for increased attention for corporate governance in a bank's risk measurement methods: a plea which is supported by the new requirements put in place by Basel II.

Similarly Bøhren and Ødegaard (2004) also showed that corporate governance matters for economic performance; insider ownership matters the most while outside ownership concentration destroys market value; direct ownership is superior to indirect; and that performance decreases with increasing board size, leverage, dividend payout and the fraction of nonvoting shares. Black, Kım, Jang, and Park (2005) investigated the relationship between governance and firm value. They found evidence that better governed firms pay higher dividends, but there is no evidence that they report higher accounting profits.

It is generally accepted without question that the activities of a corporation impact upon the external environment and that therefore such an organisation should be accountable to a wider audience than simply its shareholders. This is one of the central tenets of corporate governance and equally so of the concept of CSR. Implicit in this is a concern with the effects of the actions of an organisation on its external environment and there is a recognition that it is not just the owners of the organisation who have a concern with the activities of that organisation. Additionally there are a wide variety of other stakeholders who justifiably have a concern with those activities and are affected by those activities. Those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. This influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation.

Central to this social contract is a concern for the future which has become manifest through the term sustainability (Crowther, 2011). It seems that the term sustainability has become ubiquitous both within the discourse of globalisation and within the discourse of corporate performance. Sustainability is of course a controversial issue and there are many definitions of what is meant by the term. At the broadest definitions sustainability is concerned with the effect which action taken in the present has upon the options available in the future. If resources are used in the present then they are no longer available for use in the future, and this is of particular concern if the resources are finite in quantity (Crowther, 2012). Thus raw materials of an extractive nature, such as coal, iron or oil, are finite in quantity and once used are not available for future use. At some point in the future therefore alternatives will be needed to fulfil the functions currently provided by these resources. This may be at some point in the relatively distant future but of more immediate concern is the fact that as resources become depleted then the cost of acquiring the remaining resources tends to increase, and hence the operational costs of organisations tend to increase.

Sustainability therefore implies that society must use no more of a resource than can be regenerated. This can be defined in terms of the carrying capacity of the ecosystem and described with input−output models of resource consumption. Viewing an organisation as part of a wider social and economic system implies that these effects must be taken into account, not only for the measurement of costs and value created in the present but also for the future of the business itself (Seifi & Crowther, 2016). Such concerns are pertinent at a macrolevel of society as a whole or at the level of the nation state but are equally relevant at the microlevel of the corporation, the aspect of sustainability with which we are concerned in this work. At this level, measures of sustainability would consider the rate at which resources are consumed by the organisation in relation to the rate at which resources can be regenerated. Unsustainable operations can be accommodated for either by developing sustainable operations or by planning for a future lacking in resources currently required. In practice organisations mostly tend to aim towards less unsustainability by increasing efficiency in the way in which resources are used; this is accompanied by a pretence that sustainability is being addressed and solved rather than merely costs being reduced. An example would be either an energy efficiency programme or a programme to produce renewable energy.

One view of good corporate performance is that of stewardship (Crowther, 2002) and one of the purposes of accounting is to provide an accounting of the stewardship of the resources which have been entrusted by the owners to the managers of the firm. Governance of course is an extension of this and provides some rules by which that stewardship takes place and is accounted for. Such stewardship is that of ensuring sustainability (Crowther & Seifi, 2011). Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and using renewable resources, minimising pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future – but performance in an organisation has always been concerned with the future[3] (both short term and long term) just as much as the present.

Such sustainable activity however not only impacts upon society in the future but also impacts upon the organisation itself in the future. Thus good environmental performance by an organisation in the present is in reality an investment in the future of the organisation itself (Crowther, 2012). This is achieved through the ensuring of supplies and production techniques which will enable the organisation to operate in the future in a similar way to its operations in the present and so to undertake value creation activity in the future much as it does in the present. Financial management also however is concerned with the management of the organisation's resources in the present so that management will be possible in a value creation way in the future (Crowther, 2004). Thus the internal management of the firm, from a financial perspective, and its external environmental management coincide in this common concern for management for the future. Good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa. Thus there is no dichotomy between environmental performance and financial performance and the two concepts conflate into one concern. This concern is of course the management of the future as far as the firm is concerned.

Similarly the creation of value within the firm is followed by the distribution of value to the stakeholders of that firm, whether these stakeholders are shareholders or others. Value however must be taken in its widest definition to include more than economic value as it is possible that economic value can be created at the expense of other constituent components of welfare such as spiritual or emotional welfare. Net value created is represented by triple bottom line reporting. This creation of value by the firm adds to welfare for society at large, although this welfare is targeted at particular members of society rather than treating all as equals. This has led to arguments concerning the distribution of value created and to whether value is created for one set of stakeholders at the expense of others (see Crowther, 2011 for an exposition of this argument). Nevertheless if, when summed, value is created then this adds to welfare for society at large, however distributed. Similarly good environmental performance leads to increased welfare for society at large, although this will tend to be expressed in emotional and community terms rather than being capable of being expressed in quantitative terms. This will be expressed in a feeling of well-being, which will of course lead to increased motivation. Such increased motivation will inevitably lead to increased productivity, some of which will benefit the organisations, and also a desire to maintain the pleasant environment which will in turn lead to a further enhanced environment, a further increase in welfare and the reduction of destructive aspects of societal engagement by individuals.

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It is universally accepted that good governance is important in every sphere of human activity. Thus good governance is essential for good corporate performance (and equally for good performance, howsoever measured), in any other form of organisation. Good governance however means not just codes of governance but also adherence to those codes – something which is often neglected.

In this introductory chapter we have sought to give an overview of the extent of the scope of the concept of governance – both of corporations and of other organisations – as well as the diversity of views of what is important. We have also shown the ubiquity of the concepts in that they permeate business life as well as civil society but are understood differently in different environments and different cultures. Thus we have argued that a global framework does not exist but in our increasingly globalised world it is something which would be beneficial to international interactions and will inevitably emerge. Furthermore we argue that different cultures have something to offer in the development of this global framework. In this book therefore we explore these issues from a number of different perspectives as a means of contributing towards the development of this global system.

This book therefore makes a contribution towards the debate concerning the role of corporate governance and CSR throughout the world and the perceived need to develop appropriate standards and practices. The various contributors have sought to show similarities and differences in practice and understanding throughout the world and also that cultural issues are an important element which is often omitted from any analysis. Nevertheless the debate about such procedures continues and there is a need to complete the analysis undertaken in this book by offering some form of prognosis, albeit subject to criticism and challenge for many reasons. So we started by stating that many companies regard corporate governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important investors/potential investors and to flag up that they have such governance policies. In this book we seek to extend this understanding by looking at the true place of governance in a modern organisation

It is recognised – and amply demonstrated throughout the contributions from the various authors in this book – that these are issues which are significant in all parts of the world and a lot of attention is devoted to this global understanding. Most analysis however is too simplistic to be helpful as it normally resolves itself into a simple duality of rules based versus principles based. Our argument is that this is not helpful as the reality is far more complex. It cannot be understood without taking many other factors into account to understand the similarities, differences and concerns relating to people of different parts of the world. The aim of this book has been to redress this by asking subject experts from different parts of the world to explain the issues from their particular perspective. Our prognosis is that this debate will continue and mature and that vested interests will seek to develop codes and standards with universal application. This has not yet happened with financial reporting so will take some more time with governance and CSR. Moreover we argue that any such code or standard will only survive if it is designed to be sufficiently flexible to allow for the full extent of cultural variation throughout the world.

NOTES

1. See www.unglobalcompact.org
2. An example is the Cadbury Report.
3. This is of course the going concern principle in action.

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