

<http://www.gowerpublishing.com/isbn/9780566088933>

The Globalisation of Corporate Governance

The Challenge of Clashing Cultures

ADRIAN DAVIES

GOWER

What Drives Corporate Governance? What Resists it, and Why?

The key underlying driver of corporate governance is the need for external funding. An organisation has to attract and retain shareholders and obtain loan finance to meet funding peaks. To be attractive to investors it has to demonstrate that funds will not be wasted, but will be used responsibly to produce consistent returns for investors. Corporate governance is the substance behind such a demonstration of effectiveness and it needs to create and harness power to achieve that end.

Business is driven by the exercise of power; corporate governance is driven by the need to moderate and channel that power. Power, like its analogue electricity, is both useful and dangerous. Wikipedia defines power as 'a measure of a person's ability to control the environment around them, including the behaviour of other persons ... the exercise of power seems endemic to humans as social beings'. J K Galbraith classified power as 'condign' (based on force), 'compensatory' (through the use of various resources) and 'conditioned' (the result of persuasion), and the source of power as 'personality' (individuals), 'property' (material resources) and 'organisational' (hierarchical). Michel Foucault, the French philosopher, links power with knowledge, hence the power of doctors and priests. More recent thinking on power, e.g. Steven Lukes, focuses on the enabling nature of power, leading to empowerment. This is the key means of moderating and channelling power, and avoiding the concentration of power which makes effective corporate governance impossible, and unleashes the excesses of domineering leaders like Jean-Marie Messier, former CEO of Vivendi. As Lord Acton warned: 'All power tends to corrupt; absolute power corrupts absolutely.'

If domineering leaders can destroy shareholder value for their investors, as in the case of Marconi, are entrepreneurs, who often risk their own resources, a better model for the exercise of power? Entrepreneurs are often motivated by the need to succeed, rather than by the fruits of success, as in the case of Sir Chris Evans, who has established 20 successful science-based companies, four quoted on the London Stock Exchange including Celsis and Enzymatix. Each has moved from innovation, through nurture to maturity; each needs effective corporate governance to consolidate its success. Some entrepreneurs dislike the responsibility of corporate governance; Sir Kenneth Morrison of Morrison plc fought against it but came in line to fund his acquisition of Safeways. Others, like Sir Richard Branson, operate mainly through private companies and have limited external accountability. This is a key driver of the move to private equity structures. Few individuals can be totally self-sufficient; most will need external support even if they are self-funding, like Boris Berezovsky and other Russian oligarchs. Sovereign wealth funds

(SWF) are accountable only to their owner governments, most of which have created SWFs to invest windfall profits from natural resources. SWFs now total \$2.2 trillion (est.), and most are located in GCC countries, China, Singapore, Russia and Norway. Many banks have been partially recapitalised by SWFs since the sub-prime crisis and companies, such as Siemens, are seeking them as investors. Some SWFs have rigorous governance, e.g. Norway, but most are closed and do not publish details of their activities or of the motives behind their investments. Recently a code for SWFs has been developed by the IMF and many are promising to observe it. Is it real or just a smokescreen?

We can see that power is not always exercised openly and that some holders of power do not wish, or need, to be accountable other than to themselves or their closed circle. This situation is disquieting for other parties – the EU Commission is concerned about the risk of SWF takeover of strategic companies, and the USA is monitoring the situation closely. Trust in SWFs is low among OECD country governments and their emerging role as a lender/investor ‘of last resort’ is increasingly disquieting. The need for greater transparency is being pressed on SWFs, particularly when major banks and investment operations are subject to increasing scrutiny to block flows of ‘dirty money’. In his book *Power and Influence* (2007), Robert Dilenschneider gives copious advice on how to obtain and exercise power. His most revealing thought is ‘search for power but never forget to share it’. In a complex world of inter-dependencies, absolute power is unsustainable.

We saw earlier that corporate governance is the moderator of power and the channel for sharing it. Table 3.1 shows what drives corporate governance and what are the forces resisting it.

Table 3.1 The forces impacting on corporate governance

Drivers for corporate governance	Resisters to corporate governance
• Focus on the interests of the organisation	• Self-interest, hidden agendas
• Need to allocate power to get results	• Urge to consolidate power
• Need to achieve sustainability	• Desire to have quick results
• Managing risks	• Manipulating risks
• Picking ‘horses for courses’ to win	• Protecting favourites
• Deregulation/giving freedom to act	• Regulation/control
• Ensuring security of agreements	• Ends justify the means/utilitarianism
• Maintaining high standards	• Relativism – ‘what suits’/complacency
• Ensuring fairness between stakeholders	• Courting popularity for own ends
• Openness	• Secrecy
• Innovation/self-renewal of the organization	• Resistance to change
• Commitment	• Disengagement – ‘too much trouble’
• Leadership from all stakeholders	• Napoleonic leadership
• Trust/reputation	• Distrust/protectiveness

The pattern that emerges is of concern to protect and further the interests of the organisation, through focusing on achieving long-term sustainable results. This approach is driven by deregulation, harnessing skills and commitment and building the reputation of the organisation. The process is perpetuated through innovation and by self-renewal of the organisation's people and resources. This total pattern is strategic in intent, harnessing key elements of corporate governance to the achievement of the purpose of the organisation.

Resistance to corporate governance is founded on a repudiation of agency theory. Where employees control the operations of the organisation, which is normally the case, they fail to recognise that they are the servants of the organisation and are tempted to behave like masters. This self-serving attitude encourages hidden agendas and biases decisions in their favour. The inflation in rewards, and their divorce from business results, is an extreme symptom of this malady.

Where this malady becomes too apparent, as in scandals like Enron, Parmalat, etc., there is a grave danger of overreaction. Sarbanes-Oxley is such an overreaction which has made governance over-prescriptive and created a massive bureaucracy to police it. As we saw in Chapter 1, self-regulation is the best approach to governance in that it engenders responsibility and allows a flexible response to situations as they develop. Self-regulation, linked to a framework of laws, is a British tradition, dating back at least as far as the medieval guilds. These set standards, controlled recruitment and apprenticeship and policed behaviour. In the modern world controlled entry is less acceptable, but much of the spirit of the guilds sustains self-regulation in a more complex world. External regulation creates conflict and expense – at its extreme it could be a return to the system of the Soviet Union.

A key driver of corporate governance is the concept of fairness. The FSA refuses to define the term but expatiates at length on the subject. The OECD defines 'fairness' as 'protecting shareholder rights and ensuring contracts with resource providers are enforceable'. This implies that all shareholders have clear rights and that supply contracts are clear and even-handed. Fairness operates more widely in corporate governance, not least in stakeholder situations, and it has both legal and behavioural roots. Concepts of fairness emerged strongly in eighteenth-century philosophy, e.g. Hume, Kant and in particular Rousseau's 'Social Contract'. The legal roots of fairness lie in the courts of equity and have shaped jurisprudence ever since. John Rawls' book *A Theory of Justice* (1971) develops the principle in detail. The behavioural aspects of fairness are developed in behavioural economics as a form of preferences (Wikipedia). In the context of corporate governance, fairness is more than equity, it is certainly not equality; it is the force which drives cooperation between stakeholders with divergent interests and resists the concentration and abuse of power.

In parallel with fairness, corporate governance is driven by trust. Trust is a relationship of reliance (Wikipedia). It is at the heart of all transactions between human beings, in particular where complete knowledge is not available. Trust is particularly important where corporate governance is based on principles, since principles require interpretation to make judgements. Rules-based corporate governance is less open to interpretation, or even to explaining precedents, yet there has to be trust in the process of shaping the rules. There is debate between social scientists on the difference between trust and confidence; some believe that trust is entirely internal and only confidence is observable. This would suggest that confidence is built on facts, and that trust is developed between

people. In any case, it would seem that trust has deeper roots and can cope with greater uncertainty than confidence. One symptom of a breakdown in trust is whistle-blowing, which occurs when normal communication channels are not trusted, and which is often an act of desperation. Whistle-blowing is examined in depth in Chapter 4.

Another important driver of corporate governance is risk. All organisations need to identify and manage the risks they face in the knowledge that without risk there is unlikely to be meaningful reward. The Chinese use the same word for risk and opportunity. Awareness of risks is now a key dimension of corporate governance reporting, following the Turnbull Report. The recent crisis over sub-prime lending shows that understanding and managing risk is still not seen as important in organisations which should have better governance. It is perhaps significant that the ISO standard for risk management ISO 31000 was not published until 2009!

A document which has considerable impact is an article 'Confessions of a Risk Manager' in *The Economist* (9 August 2008). This details the structure established to manage risks and the resources devoted to the task. It shows how sentiment about risk in this bank moved from believing that it could not happen, and monitoring classic market risks, to a realisation that traders were moving into uncharted territory in pursuit of profit and creating overload in risk management. Pressure was applied through top management to approve deals with only cursory examination and any challenges from risk managers were overruled. A balance sheet of traded assets was built up whose credit ratings collapsed when marked to market. Risk management was not seen as a real function but as a decoration to appeal to external parties, such as shareholders and auditors. Good staff went into trading; risk managers were seen as gadflies, not goalkeepers.

One of the crucial drivers of corporate governance is competition. Few organisations now enjoy a monopoly, and innovation is valuable only until competitors catch up. Where competition is imperfect, as with some utilities and financial services, regulation intervenes to simulate competition. My book *A Strategic Approach to Corporate Governance* (Davies 1999) explores in depth the contribution of effective corporate governance to achieving competitive advantage and this book will update its findings. In *Best Practice in Corporate Governance* (Davies 2006) I listed and explored the Eight Core Dimensions of Corporate Governance:

- the identity of the organisation;
- the purpose of the organisation;
- leadership;
- the distribution of power within the organisation;
- inclusiveness and communication;
- the pattern of accountability required;
- the maximisation of effectiveness;
- ensuring sustainability.

Competitive advantage is achieved by organisations which keep these dimensions in focus and updated, aware that they have to excel in them all in order to compete successfully in the long term. Organisations need to innovate to maintain a competitive edge; a company which has prospered through product innovation is Reckitt Benckiser. Organisations also need to adapt to change; Man Group emerged as a FTSE 100 company when it restructured to focus on derivatives trading. Competition is Darwinian in its

impact; companies which do not adapt face a fate similar to British Leyland. Corporate governance needs to anticipate the impact of competition to ensure the survival of its organisation.

The key internal driver of corporate governance is leadership. In *Best Practice in Corporate Governance*, I stated:

Leadership is the driving force behind corporate governance. It maintains a firm focus on purpose and enables those involved to set each other an example in working to achieve it. Leadership is not the sole prerogative of one person, or a self-selecting group; leadership may change depending on circumstances, for example, a technical specialist may lead in a situation where patents are crucial.

Leadership depends on trust and the competence to fulfil the role required at the time. In a crisis, leadership may have to be brought into an organisation in the form of a 'company doctor', in order to ride the crisis, stabilise the organisation and hand authority back to a new board. Leadership in corporate governance is not like the Berlin Philharmonic Orchestra under Herbert von Karajan, but more like an eighteenth-century chamber orchestra, with a continuo on the harpsichord, the lead passing from soloist to soloist.

External Drivers

There are a number of key external drivers of corporate governance, whose role complements or stimulates the internal drivers discussed above. Each of these operates separately, although on occasion they may operate in concert to greater effect. These external drivers include:

MEDIA

All forms of media can impact on corporate governance – all do when there is a major scandal, such as BCCI. Mass media targets large audiences and will focus on corporate governance when a major story breaks, such as the crash of Barings Bank, and will rarely feature issues of corporate governance prior to a striking dénouement. Journalists love colourful characters, so that business leaders like Sir Richard Branson get regular coverage; villains like Robert Maxwell are even more interesting. Apart from such occasions mass media do not feature issues of corporate governance.

Business and economic media, e.g. *Financial Times*, *The Economist*, etc., devote resources to the analysis of key businesses and seek the opportunity to interview key business leaders and opinion-formers (NGOs, lobby groups, business academics, etc.). As journalists the contributors to such publications are looking for unusual 'angles', signs of discord on the board, difficulties with contracts, etc., which make news. They can also find weaknesses in press statements and probe to uncover the true situation, e.g. the statement that Bradford and Bingley did not need to raise new equity was rapidly belied through the media.

The role of the media in corporate governance is one of challenge. Organisations have become expert at 'spin' – the presentation of the upside of the situation with suppression or distortion of its downside. The media are not impressed by public relations, they seek

a story to interest their audience. Challenge from media is forcing greater openness on organisations and making them accountable for true situations rather than myths. This may not be the purpose of media but it has been a powerful driver of better corporate governance, e.g. Shell's activities in the Nigerian Delta.

STAKEHOLDERS

Stakeholders have emerged from the background of corporate governance to a prominent position in the foreground. The Companies Act 2006 confirms their legal status in company law and the development of corporate social responsibility widens their circle from employees, customers and suppliers to encompass other constituencies which impact on the organisation, e.g. the local community. Stakeholders drive corporate governance in varying ways and degrees: some, like employees, have a fundamental impact on the organisation; others, such as government, impact less directly and frequently. The stakeholders with the largest potential to drive corporate governance are shareholders. Their impact has been limited until recently but there is a growing weight of evidence linking good governance to improved company performance, e.g. McKinsey 'Global Proxy Watch' 6 No. 30 (2002), and that investors are willing to pay a premium for good governance. Fuller evidence may be found in *The New Capitalists* (2006) by Davis, Lukomnik and Pitt-Watson. Shareholder activism is increasing as institutional investors need to produce higher returns.

Stakeholder involvement in company direction is increasing as stakeholders other than shareholders seek to benefit from the wealth-creating potential of business. NGOs and charities are laying claims to be stakeholders, buying shares to legitimise their claims. Governments have for many years exploited company wealth through taxation and harnessing companies to work for them, e.g. collecting employee taxes. It seems inevitable that stakeholders will seek to increase their benefits from association with companies through exploiting corporate governance and the greater wealth it produces.

ACTIVISTS

All stakeholders are becoming more active but some wish to be involved in their organisations, either by having a seat on the board or by offering specialist advice. In the USA it is almost impossible for shareholders to nominate board directors, except through expensive proxy battles, such as that waged by Robert Monks at Sears, Roebuck in 1991. Board elections are a formality – the term 'soviet style' has been used. Pressure is now on to change US legislation to make board nominations and elections more democratic, e.g. from the Council of Institutional Investors. Other examples of activist board nominations are TCI's attempts to improve governance in J-Power, a Japanese utility, which failed. TCI is one of a growing number of activist investors seeking to open up companies to improved corporate governance and, as a consequence, enhanced profits. Others are George Soros, PIRC, Knight Vinke, ADAM (France) and major pension funds such as CalPERS and Hermes. Some are descendents from the 'corporate raiders' of the 1960s, such as T Boone Pickens and Carl Icahn, but most are now more than opportunistic. Eric Knight of Knight Vinke claims to have forced the restructuring of Shell and is now challenging the strategy of HSBC. Colette Neuville of ADAM challenged the corporate governance of EADS and has joined the board of Eurotunnel. PIRC is very critical of the

lack of openness of fund managers to independent scrutiny; it does not place directors on boards to protect investments in the manner of 3i, but is a specialist adviser.

The specialist adviser activists are spearheaded by major fund managers, such as CalPERS. Their approach is based on broad analysis to find companies which will benefit from improved management and to work with boards to have their ideas implemented. The method has a low profile and is backed by shareholding. Credit for success usually goes to management but the adviser has an improved investment. A similar approach is used by Hermes (see my book *Best Practice in Corporate Governance* [Davies 2006] and Chapter 8 of this book).

The impact of activists is increasingly being felt and some, like PIRC, are using their experience to intervene in the minutiae of governance, e.g. the management of general meetings. It is in these areas of process that most progress has been made; major attempts to change strategy or structure, e.g. Carl Icahn's attempts to break up Time Warner, still meet entrenched resistance. More time is needed to effect major change, but developments such as the Myners Report 2001 are powerful signposts to progressive change.

REGULATIONS

Where there is a high degree of trust, regulation is watchful but inactive. In the real world regulators find themselves acting as referees to ensure fair play between competitors. When do regulators become drivers of corporate governance? Usually regulators show their teeth after a crisis or a scandal; the UK Pensions Regulator was established in the wake of the collapse of company pension schemes in the 1990 recession. Regulation appeals to bureaucrats and is usually self-perpetuating. The 2005 Hampton Review of the UK regulatory system sought better regulation based on a risk based approach and proportionality in enforcement, rather than the 'blanket' model of regulation in force earlier. Regulators are now expected to work with clients and avoid disruption of their activities. They now report to the Department for Business, Innovation and Skills (BIS). The 2007 Regulators' Compliance Code should encourage companies to drive for better compliance voluntarily, leaving the regulator to act as a coach rather than a policeman.

A new book by Howard Davies and David Green, *Global Financial Regulation* (2008), turns the attention of regulators to the need to update international regulation, which is piecemeal at present (with the EU a bureaucratic player) and focused on old models, rather than hedge funds and private equity. With the growth of multinational companies, regulation is fragmented across different regimes and it is now common for operations to be located in low-regulation countries (following the migration of tax liabilities). This process was a major contributor to the recent financial crisis, reaction to which may facilitate moves towards better regulation.

Key Resistors of Corporate Governance

ENTRENCHED POWER

One of the strongest resistors of corporate governance is entrenched power. This may be in a family controlled organisation, where ownership legitimises control, or it may be in a company with well-established executive directors, usually led by a powerful CEO. All too

often, such a person is both chairman and CEO (this is the norm in the USA) and controls all the levers of power. Danger signals include:

- a non-challenging finance director;
- complacent non-executive directors (hired by the CEO);
- executive directors all 'home grown' (and compliant);
- entrenched auditor;
- high proportion of long service employees but above average staff turnover;
- low product innovation;
- above-average reward packages for executive directors.

Such situations are difficult to remedy. They were at the heart of much of the collapse of British manufacturing in the 1980s – spurred on by unions which had to be 'bought out' – and destroyed by international competition. The Higgs requirement for independent directors should help, but will independent-minded candidates want to risk their reputation in the court of the Borgias?

HIDDEN AGENDAS

Enron appeared to be an exemplary company but it was consumed by hidden agendas. The only antidote to hidden agendas is a strong culture of openness, explaining reasons for actions and documenting them in detail. Internal audit is usually seen as a protection against fraud; a good internal auditor can detect mismatches between arguments and actions. Decisions taken in the interest of the company cannot logically benefit individuals or cliques disproportionately. Hidden agendas may include insider trading, commercial espionage, favouring family or outsiders at the expense of the organisation – and just plain fraud.

RESISTANCE TO CHANGE

Change usually involves discomfort and few are as enthusiastic for it as 'Pioneers for Change', the young person's global learning network. In his blog, John Burnside of Dundee University, reminds us that 'The Book of Changes is a classic of early Chinese literature, with the key message that change is the essence of life. He points out that 'revolutions are few ... (but) systems will continue to evolve, in businesses ... that is what the real world is about'. If change is inevitable even though unsettling, it makes more sense to harness rather than resist it. Most major changes impact on organisations from outside, and few can be ignored, let alone resisted, for long before the organisation is damaged. Some key changes occur inside the organisation, such as the unexpected death of key directors or the atrophy of core assets, and inaction is no defence against these. Directors who resist change, rather than harness it for the benefit of the organisation, are in clear dereliction of their duty.

SECRECY

The standard justification for secrecy in business is to defend competitive advantage. The growing use of 'Commercial in Confidence' headings on documents hints at wider

motivation. Some information is legally required to be kept secret, e.g. medical records, but patterns of pay should not be secret – they are needed in any case for recruitment. Important technical secrets can be protected by patents; lesser ones are not usually secret, but are shared on a ‘need to know’ basis. Secrecy causes mistrust between people, which hinders the smooth running of corporate governance. It is usually counterproductive. Sophocles wrote: ‘Do nothing secretly; for Time sees and hears all things and discloses all.’

One area of secrecy has been private equity, created in order to avoid public accountability. Concern has been expressed by other investors, especially over discriminatory tax relief on interest payments, so that an enquiry by Sir David Walker led to a voluntary code of conduct for the industry – Pemira, CVC and others are beginning to lift the veils of secrecy over their operations.

For many years Whitehall has used the Official Secrets Act 1911 as a cloak to cover incompetence as much as state secrets. It is a bad model which should not be followed by business. A report from the Chartered Management Institute of the views of 1,500 managers (March 2006) found only 12 per cent cited a ‘trusting culture’ in their firm. Secrecy was seen as crushing entrepreneurial spirit in the workplace, creating suspicion and aversion to risk.

If 88 per cent of British firms lack a ‘trusting culture’ the road to improving corporate governance is very stoney!

DISTRUST/MISTRUST

Distrust is the spirit of the relationship between antagonists – the West distrusted the Soviet Union in the Cold War. Mistrust is created by uncertainty whether another party has a hidden agenda. Distrust can be positive, as when directors challenge managers to find and test the truth, or when shareholders hold directors to account. Distrust depends on a mutual belief that both parties are ‘playing a game’. When this mutual belief breaks down, mistrust takes over. Many scandals have occurred because the distrust relationship was not working; where there is no challenge, the truth cannot be discovered in time to prevent a crisis.

In respect of the principal:agent relationship, such as between shareholders and directors, a study by Falk and Kosfeld (2004) of a large number of principal:agent pairings showed that restricting agent flexibility and offering explicit incentives for targeted outcomes was counterproductive and costly. Most principals were found to give their agents wide discretion and to achieve better results than those seeking tight control of means employed.

Other Issues Driving Corporate Governance

COST

Many companies see corporate governance as a burden and resent the growing cost of compliance. This view has been reinforced by the funding impact of Sarbanes-Oxley and its effect on companies’ operating flexibility. Scott McNeally of Sun Microsystems sees SOX as ‘one of the most damaging buckets of sand in the gears of the market

economy that were ever voted 98:0 on in Washington'. He sees the cost to major public companies as at least \$5–10 million each for no benefit. A report on smaller companies underlined the higher relative cost of compliance with corporate governance rules (SEC Size Subcommittee 2005). Professor Cox of Duke University suggests that much of the real concern to reverse SOX is due to its effect of making reporting on management more transparent to directors and owners. Management is now more accountable and at a disadvantage. Pressure for reversal is also coming from US lawyers who cannot match the lower legal fees offered by European law firms.

In the UK an article by John Leyden in *The Register* (Leyden 2004) claims that UK government plans to improve corporate governance will cost millions of pounds. This will be triggered by the Companies (Audit, Investigations and Community Enterprise) Act 2004, which he sees as the equivalent of SOX. Much of the cost will be upgrading IT according to Butler Group. The stated aim of the Act is 'to improve investigators' access to information, reduce the possibility of delay or obstruction by companies under investigation and remove a possible deterrent to individuals volunteering information'. Section 448 provides protection to 'whistle-blowers' who provide information to assist the inspection.

While it is salutary to recognise the growing cost of corporate governance, the benefits emerge in the increasing adoption of best practice in governance and in the pattern of improved business results achieved by serious practitioners.

WHISTLE-BLOWING

The term 'whistle-blowing' derives from the practice of English policemen to blow a whistle when they noticed a crime being committed. Wikipedia defines a whistle-blower thus: 'an employee or member of an organisation, especially a business or government agency, who reports misconduct to people or entities that have the power and presumed willingness to take corrective action. The misconduct may be a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations and corruption.' An example cited is Jeffrey Wigand who exposed the Big Tobacco misinformation scandal and the connivance of tobacco company managements.

Most whistle-blowers have suffered for their action, through dismissal (as at Enron) or by persecution, even in some cases, criminal prosecution. It may be significant that most whistle-blowers whose action is publicised seem to be women. In the UK the Public Interest Disclosure Act 1998 provides protection for whistle-blowers who act in good faith. Protection in the USA may now be provided by The Whistleblower Protection Act 2007, even to most government employees whom the Supreme Court earlier disbarred from protection under the First Amendment of the Constitution.

Public perception of whistle-blowers changed from seeing them as 'sneaks' when the enormity within Enron became public knowledge. Protection for whistle-blowers outside North America and the UK is fragmentary. EU competition law does include a leniency policy but case law to date is limited.

THE VALUE OF CORPORATE GOVERNANCE

A report in *The Guardian* (27 February 2008) by Jill Trenor 'Poor Governance Reduces Profits says ABI' quotes an Association of British Insurers study which showed that

companies with the best corporate governance record produced profits 18 per cent higher than those with a poor record over four years. The study covered 241 companies, and established that governance drives performance, not the reverse. The lags between poor governance and inferior performance were typically two to three years. In the case of Northern Rock the ABI had alerted shareholders over four years about excessive executive bonuses before the business imploded.

An article by Skaife, Collins and Laford (2004) focuses on the cost of capital and how activist institutions, such as CalPERS, have been reducing the cost of capital through their work on reducing information asymmetry between shareholders and managers, and reducing agency risk. A study by Deloitte North America and the EIU, 'In the Dark' (2005), found that compliant companies were able to improve revenues, safeguard assets and improve efficiency with a positive impact on share price. Specific benefits cited include:

- improved disclosures, leading to greater investor confidence;
- standardisation of processes and controls, reducing costs and increasing efficiency;
- better control over management and information systems, increasing internal security;
- improved acquisition integration, highlighting systems incompatibilities;
- reduced risk of loss through fraud, protecting assets and reputation;
- enhanced market confidence and reputation management, avoiding earnings restatements and delayed announcements.

A paper for the SEC by Tefara and Peterson, 'The True Values of Corporate Governance' (2004), examines the cost of corporate governance but concludes that they are small by comparison with the confidence which good governance gives to investors. It sees the most effective aspects of corporate governance to be:

- a strong board of directors, independent of management, but with expertise to oversee management;
- management compensation oversight;
- strong corporation laws and regulations to protect the rights of shareholders;
- extensive public disclosure requirements, both financial and non-financial;
- a robust independent audit function.

These aspects need to be supported by credibly strong government and market enforcement mechanisms. Given these supports, companies with the highest standards of corporate governance can expect 'to attract investors on the most favourable terms. In short the best public companies will continue to view strong corporate governance as an investment well worth making' (Tefara and Peterson 2004).

An alternative approach to evaluating corporate governance is to measure the economic value added which it produces. One such measure is Economic Value Added (EVA), developed by Stern Stewart and Co., a consulting firm. A paper entitled 'Measuring Economic Value Added (EVA): How Corporate Governance Works for Shareholders' (Stern Stewart and Co. 2008) shows the four-step EVA calculation which is widely used in accounting and finance. In respect of corporate governance the key benefit is to be able to incentivise managers towards maximising returns to shareholders by treating

them as a franchisee, as if owning a franchise within a larger enterprise rather than as employees

GOVERNMENT

In the past UK governments have not sought to drive corporate governance, other than through the Companies Act and linked legislation, supported by regulatory bodies to encourage it, e.g. the FSA. The EU Action Plan on Company Law and Corporate Governance (2003) involves legislation and proposals for action to make European business more open and competitive, and the Companies (Audit, Investigations and Community Enterprise) Act 2004 gives government additional powers of access to companies whose governance may be suspect. It seems that SOX may have been a watershed between liberal and interventionist government attitudes to corporate governance. It is to be hoped that economic nationalism remains the exception in approaches to the ownership of companies, but business managers will need greater self-control than has been evident in the recent banking crisis if encroachment by governments of the 'free market' economy is to be resisted successfully. It is difficult to envisage any normal situation in which governments should drive corporate governance. They are not parties to a purely commercial relationship and should facilitate a sound economic environment in which businesses can flourish rather than seek to direct their policies. The situation in Russia, Venezuela and other benighted economies is no model for twenty-first-century corporate governance.

The Present Balance of Forces in Corporate Governance

Looking at the situation in many emerging countries makes it easier to appreciate the progress that has been made in OECD economies towards effective corporate governance. In most cases, owners have become more involved with their companies and have put more pressure on managers to perform. Greater openness has revealed problems which might have remained hidden in the past, and increased accountability is shown in the shortening tenure of CEOs.

Despite considerable progress since the warning from Berle and Means in *The Modern Corporation and Private Property* (1932) the balance of power between owners and managers still favours the latter. As business becomes more complex the value of incumbency and access to information increases. Owners can rarely be as immersed in their company as managers, particularly when most of them are portfolio investors. Owners rely on auditors to protect their interests, and pay them to do so through the company, yet auditors may be readily 'captured' by managers, since they need their cooperation to function economically. The power of employees has waned in recent years, partly due to the decline in trades union membership. This has reduced pressure on managers and given them more freedom of manoeuvre.

The influence of other stakeholders remains strong; managers need customers and suppliers to function effectively, and government imposes increasing burdens on business. NGOs are becoming more active, often supported by shareholding, so that companies have been driven into corporate social responsibility programmes and charity support, even as the size of political donations has declined.

Companies need to maintain a focus on their core function of producing wealth for their owners. Successful companies manage to be socially responsible without losing concentration on their core function. A key test of 'good' companies is the degree of pride stakeholders have in being associated with them; that pride is not only in the company's financial results, it is also in the style and culture which helps to produce and sustain them.

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