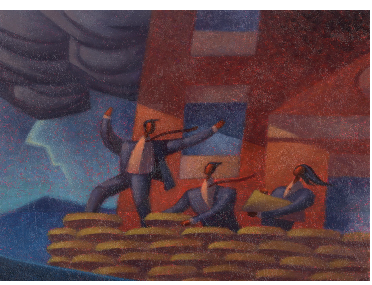

PRINCIPLES FOR RESPONSIBLE MANAGEMENT EDUCATION COLLECTION

Oliver Laasch, *Editor*

Responsible Governance

International Perspectives for the New Era

Tom Cockburn
Khosro S. Jahdi
Edgar G. Wilson

A CRME PUBLICATION

PRME Principles for Responsible Management Education

BEP BUSINESS EXPERT PRESS

Responsible Governance: International Perspectives for the New Era

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Abstract

Evolving stories of governance and change are being written into the emerging custom and practice of all kinds of organizations today, whether they are global or domestic, startup or blue chip corporate or government agency. Changing ways of 'doing business' are not new, nor is globalization of business but the velocity and trajectory of both are rapidly accelerating beyond those seen in previous times. In summary, we see an increasing pace of change as the integration of global supply chains and businesses capabilities facilitated or enabled by new digital and other technologies grows adding complexity to already-complicated trading and commercial systems internationally and domestically. Such dynamic complexity is not solely determined by technology and we must also be cognizant of core enabling political, economic, social, legal, environmental and cultural factors in the behaviors of organizations in the global Business and governmental context.

In parallel with these changes to social and business norms and practices, there are increasing concerns and challenges for the boards of directors and other governance systems and processes which are intended to ensure good stewardship of the diverse organizations engaged in public or private sector business and their activities globally in the period following the global financial crisis. This book aims to challenge assumptions and present current debates for readers, grounding the critical issues or descriptions in relevant historical and social contexts as well as suggesting ways forward. Authors look at governance of organizations with varied structures, from a number of industries and nations from across the world. The chapter authors discuss many cases and themes of Corporate Social Responsibility from a variety of legal, social or political perspectives, presenting the reader with a rounded evaluation of the relevant legal, social, technological problems, issues, innovations and other insights.

Keywords

Globalization, Governance challenges, Corporate Social Responsibility, dynamic complexity, Principles of Responsible Management Education (PRME)

Contents

Preface

The aims of authors in this book are to provide readers a set of lenses to take a broad view across the wide vista of governance practice today at all levels: from top to bottom and left to right. The canvas is large, so broad strokes are used but with significant outlines of concepts, theories, and models to enable readers to discern figures in the foreground and background. We recognize that amid the diversity of philosophies and of ideologies, there are both implicit and explicit hierarchies of power, influence, resources, and systems, which impact and interact differentially in or between each of the constituent actors on stage, be they principals or agents.

As a group, the authors also recognize the imperatives of preparing the next generation and framing leader development and management education to ensure that the UN's principles of responsible management education (PRME) are reflected in the ethical governance processes and agendas discussed. Such a mission often involves attempting to change the conventional mindset of leaders from envisioning a command and control system based on a Newtonian, "clockwork" world, to one of appreciation of global complexity and successful leadership through influence and agility. To that end, they must become aware of the incipient and evolving changes in global business and government contexts. Such complex change processes do not often follow linear trajectories from A to B to C, but instead may often spiral in a tangled "spaghetti" of feedback loops amplifying or diminishing each other as they intersect and interact in a self-organizing manner over time.

The book addresses and presents an overview of key perspectives on governance processes encompassing topics of interest and concern to current and aspiring leaders confronting emergent global complexity. We expect this intellectual "smorgasbord" to be of value to upper-level students in universities and colleges, as well as to the general reader and academic researchers seeking "food for thought." Intentionally therefore, this book is not specifically aimed at technical, legal, or functional specialists.

Nevertheless, the broader strategic focus stretching across many continents, including references to technology governance, illustrative case commentaries herein may be successfully applied to their current governance roles or to roles they may subsequently acquire.

Holding that academic rigor as well as professional integrity and due diligence requires thoroughness and scrupulous attention to details, chapter authors have critically analyzed the ethical, technological, political, and business challenges facing many organizations in different regions. In particular, they have paid attention to cultural values, priorities, issues, and related assumptions of governance from diverse perspectives while bearing in mind the UN's PRME as they relate to chapter topics and relevant readerships.

The themes and approaches do not entail any assumptions as to skills or expertise of users and are comprehensible for both technical and non-technical readers, so enabling all readers to readily see how to apply the models to their own evolving situations. Potential uses include, but are not limited to, personal, professional, and organizational improvement, used as a reference source on key issues in many regions or particular circumstances, library reference, or upper-level course supplement for students and instructors.

However, these texts are not a substitute for leadership experience since as Warren Bennis has previously stated:

> Leaders learn by leading, and they learn best by leading in the face of obstacles. As weather Shapes Mountains, problems shape leaders. Difficult bosses, issues in the executive suite, circumstances beyond their control, and their own mistakes have been the leader's basic curriculum.
>
> (Bennis 2009, 138)

That is "learning by doing" or action learning (Revans 2012).

Leaders obviously cannot experience all situations and contexts or perspectives and so must continuously validate and triangulate their ideas and information with other sources. Although this is not a "how to" text, part of the mission of this book is to provide some "brain food" to nourish thought and action for experienced and inexperienced leaders as well as other reflective readers.

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CHAPTER 1

Provocations to a Debate

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Abstract

This chapter provides a contextual overview to enable the reader to locate the book within the panoramic vista of the rapidly evolving global business environment confronting executives and boards of all organizations whether they are multinational corporations or government agencies. That context is briefly outlined and the significance of the book topic and themes are presented as well as commentary and discussion of the conventional models of the key roles, responsibilities and expectations or assumptions regarding governance and governing bodies. The direction taken and the provocative as well as analytical or descriptive focus of each of the chapters in the book are briefly discussed with respect to key participants, agencies or stakeholders across many countries and regions.

The reader is thus enabled to approach the rest of the book with a broader, strategic awareness and compare or contrast the diverse models, cases and themes presented by the authors.

Keywords: leadership, governance, ethics, gatekeepers, corporate social responsibility, sociodigital technologies, complexity.

Introduction

The main overarching rationale for the existence, function, and role of corporate governance (CG) bodies can be briefly summarized as ensuring that enterprises are managed in such a way that their operation does not infringe or inhibit the rights of the wider community or of particular groups of their stakeholders. Today the boards of listed companies in developed countries are generally also seen as a mechanism for ensuring accurate risk intelligence, for directing the company effectively and sustainably while monitoring the agency costs of executive and operational management systems. This involves a notional I owe You (IOU) regarding the future. The future, however, is inherently and increasingly uncertain or ambiguous; hence, the nature and value of any future claim is also uncertain. That is, it is contingent on events that have yet to occur. If the same information is available to all, then informed judgments about the likely future value of assets and their protection may level the playing field for everyone of average intelligence, awareness, and interest. Less capable stakeholders will require additional protection and support from exploitation and loss.

The twenty-first century CG had a relatively poor birth. The metaphorical "gestation" was a period of "gung ho" deregulation and enterprise culture under conservative political leaders such as Reagan and Thatcher. The decade before the new millennium saw a number of high-profile scandals mainly in the United Kingdom and United States, although there were also international repercussions. The year 1990 saw Polly Peck share price crumple as the scandal and CEO Asil Nadir convicted of theft of company funds. In 1995, Barings Bank collapsed and Nick Leeson the futures trader was jailed for his part, though the lax supervision resulted in the senior directors' disqualification.

The 1990s culminated in an era of excess as well as success and arguably the motto "greed is good" was a core value for many, often justifying excessive, equity-based pay for CEOs and dubious "shortcuts" such as neglecting too close an oversight, enabling obvious manipulations and conflicts of interest to pass without comment or victimization and silencing of potential whistleblowers (Jensen and Murphy 2004; Coffee 2002; Gordon 2002).

The twenty-first century began with a number of corporate scandals such as WorldCom, Enron, and Anderson being exposed in 2001/2002. That happened despite them having developed elaborate ethics codes. The subprime debacle led to the Global Financial crisis of 2007/2008. Often, as in the 1990s, the causes were greed, fraud, accounting malpractice, serious mismanagement, and lax auditing of a number of large corporations' business practices. At the same time, various potential "gatekeepers" of companies' moral integrity and probity, such as investment bankers, business lawyers, and rating agencies, often in part, assisted these system and organizational failures (Belcredi and Ferrerini 2013).

There remains considerable diversity and debate around the role of governance boards and their relationship to others, from the C-suite to the shopfloor or the investors. Despite the spread of governance codes, there remains considerable diversity of implementation and functions accorded to the boards as well as who is eligible to be a member even within the European Union (EU) and more so elsewhere in the world. Core issues revolve around the structure and representative composition of boards, the role of independent directors, the unified or separated roles of CEO and chairman, the organization's ownership structure (including publicly owned organizations), board remuneration policies and practices, shareholder activism, and increasing open CG disclosure. So problems arise with flawed governance systems and with the criminal or incompetent administration of them.

However, the alignment between agents and principals may not be as clear-cut or may be more closely tied to the agents' personal wealth, or desire to retain control. Some such costs are obvious such as the financial amount of payments and bonuses for senior managers, CEOs, and others are less overt such as the growth of information asymmetries between board and others and undermining accountability to the board's stewardship. As argued elsewhere,

> The issuance of multiple voting shares provided Facebook's founder Mark Zuckerberg with voting control in excess of his stake in the company. Indeed, he owned approximately 28 percent of his company following the IPO, but the dual class share structure allowed him to exercise 56.9 percent of the voting power, thereby curtailing shareholder rights and reducing the influence of the board of directors (McCahery, Vermeulen and Hisatake 2013).

As these authors state, there are those who agree with Zuckerberg's dual shares approach—which is not uncommon in many of the social media and related companies. Oracle cofounder Larry Ellison sees the retention of control in this way as a means to protect the company from indifferent, uninterested, or incompetent boards and cites Steve jobs' sacking from Apple as a case in point (McCahery et al. 2013, 151–2).

Aside from company founders who do not wish to "let go" of the reins of a listed company or other forms of personal aggrandizement in different industries, public service sector, or professions, there are other issues to be addressed. There are currently no universally agreed, enforceable, global governance standards for listed businesses or public bodies in the same way or to the extent that there is with ISO numbers for product specification. Typically, board dynamics and investor relations are often ignored in the CG debate, although as Heskett noted with respect to the United States (2001, 2)

> Among board committees, the audit committee has historically received the most attention. Not only are boards expected—and in case of publicly financed organizations required—to have one, independent, so-called "outsider," director membership on the audit committee has been strongly prescribed. Increasingly, audit committees are called to task for their responsibilities and required to co-sign important communications to shareholders . . .

> However, in the same year that WorldCom and Enron scandals erupted, he also remarks that:
>
> While all of this is going on, of course, governance continues to go astray. An organization's books may be in order, but its performance may be going down the tubes. What's to be done?
>
> (Heskett 2001, 2)

In the same Harvard Business School paper, Heskett (p2), referring to the Service Profit Chain model, argued that customer and employee satisfaction and loyalty measures are far better predictors of future financial success than are measures of past financial success. Consequently, these kinds of people items should feature strongly in any organization's balanced governance scorecard, along with the financial measures. He leaves open how often and when such reporting measures should be employed, to whom they must be communicated, and whether (or not) this process ought to be overseen or mandated by the Securities Exchange Commission (SEC). Other matters such as whether the CEO and chair of board should be separated and the extent that company "outsiders" are truly independent rather than spouses or friends of the current CEO (or of new CEOs) are not discussed. There is some research suggesting such friendships feature strongly in the looseness of board oversight. In addition, should investors be briefed on ways that the Initial Public Offering (IPO) listing may be manipulated to favor the current or future leaders retaining more control than other shareholders as in the Facebook example earlier? In light of the rapidly accelerating changes due to the developments in technology, there could be a case for retention of the expertise of such leaders in the early stages of the company post-IPO provided that the information asymmetry is remedied or neutralized in other ways, e.g., by acquiring independent directors or board committees of comparable knowledge and skill as a counterbalance and adding more academics and women to increase independence and board diversity.

Much depends on the scope of corporate laws that apply and on the nature of the company shareholding for public companies. The result is an unstable balance between convergence and divergence, shareholder and stakeholder influence, and European v. national rulemaking (Davies and Hopt 2013). Although several chapters here address the diversity of laws and regulations, established or evolving codes for legal governance alongside leaders' focus, and capability and will to ensure ethical and responsible governance, we take a much wider perspective. Authors seek to encompass political, social, technological drivers and the impact of the rapid pace of change confronting governance systems.

Although physically the same size as previously, the world is becoming, figuratively speaking, ever-smaller in terms of the global reach of digital communications technologies, global business, and the span of travel and tourism. In cultural, social, and economic or business terms, emerging sociodigital technologies can be disruptive. There are positive and negative effects of this on culture, health, welfare, security, and governance at all levels. So the book has one key theme, which concerns technological drivers of change.

As Nye (2013) states,

> World leaders have not yet figured out how to reconcile the moral conviction that all people are equal with the simple fact that all countries are not. In a global information age, governance systems capable of addressing fundamental issues like security, welfare, liberty, and identity will require coalitions that are small enough to function efficiently and a decision concerning what to do about those who are underrepresented.

Other features suggested include forms of knowledge as power such as the development of "Datocracy" where an elite controls the flow of information as well as the smart machines underpinning the conventional or "first economy." That is achieved by controlling the largely invisible machines that run much of the goods and services in the "second economy" (Arthur 2011).

In the era of big data, artificial intelligence, and smart machines as referred to earlier, we have some proponents of a system of "algorithmic governance" as described by Evgeny Morozov 2014, in an article in "The

Guardian Newspaper in the UK." Basically, "algorithmic regulation" or "cybernetic governance" is a system of control and governance of behavior via an extension of the apps and sensors in much current domestic technology in the home, in the car, in your watch or smartphone, and so on. The governance here is premised upon the ubiquitous and standard installation and "invisibility" of smart sensors in cars, phones, fridges, and other devices. The sensors collect data, which can be analyzed and used to promote, prevent, or forestall certain behaviors by establishing a pattern and "remotely" controlling the negative behaviors or encouraging positive behaviors including purchasing decisions. On the positive side, your fridge, for instance, can tell you that you are running low on some food items or alert health professionals or insurance companies to unhealthy behaviors. Your car can sense and forestall a potential collision by regulating the cars speed, direction, and closeness to hazards. In the United Kingdom, the use of these sensors to control behavior has been proposed by a ThinkTank, for instance, using private car traffic/safety sensors as a means of controlling traffic flows, reducing speeding drivers, or enabling the police to stop the car remotely. Health care and insurance organizations see potential for reducing unhealthy lifestyles in the public and insurance premiums or health care costs (Morozov 2014).

Other themes include the interplay of complex cultural, sociopolitical, legal, and moral imperatives and the impact of global demographic changes on power hierarchies and spheres of influence. Castells (2007) has hypothesized that a number of media trends are converging toward change in the relationship between the leaders and the powerful and between them and those who contest their influence or those who wish to resist or reduce such leaders' influence in various policy arenas or theaters of action. As a result of these power shifts and social media trends, there have been adaptations in resisters' and cyber activists' armory such as "Google bombing" and "Googlewashing," which Castells (2007, 257) describes as ". . . cultural battles that are fought to a large extent in the communication realm".

Globally, other critical issues have emerged. For instance, migrations of workers, jobseekers, and refugees have increased the potential talent pool and the potential spread of some diseases and conflicts of various kinds. The social stability and normative "balance" of cultures has tipped into a new rhythm and pace in many areas. Digitization and globalization initiated a process of radical change in business and government effectively rewriting many former norms and implicit "rules" of how things are done. Nevertheless, the disruptive digital technology referred to in this volume is about more than new communications systems.

A new breed of industries has emerged, alongside and parallel to increasing levels and integration of global digital connectivity across all domains of personal and professional life. Smaller players have been able to enter a market and offer online products and services that undercut the preexisting market leaders. On the other hand, scanning for such new frontiers—and related risks—is also demanding more "tech-savvy," more mental flexibility, more emotional adaptability, and more openness from CEOs, board chairs, heads of government ministries, and other leaders (Jaruzelski et al. 2011; Burghin et al. 2011; McKinsey global surveys 2012, 2013; PWC 2014).

Discussing the 2013 McKinsey global survey data, the authors stated:

> Across most of the C-suite, larger shares of respondents report that their companies' senior executives are now supporting and getting involved in digital initiatives . . . This year, 31 percent say their CEOs personally sponsor these initiatives, up from 23 percent who said so in 2012. This growth illustrates the importance of these new digital programs to corporate performance, as well as the conundrum that many organizations face: often, the CEO is the only executive who has the mandate and ability to drive such a crosscutting program.
>
> (Brown, Sikes and Willmot, August 2013)

In an Opinion piece in *The European* magazine, on January 10, 2014, Nancy Birdsall remarked upon the weak state of the global governance infrastructures:

> The world does have a set of intergovernmental institutions that make up global governance and are meant to address global challenges: the World Bank, the IMF, the G-20, the World Health

> Organization, the recently created Global Climate Fund and many more. But their actual powers are relatively limited. The "system" of global governance is weak and ineffectual—unable, for example, to tax mobile capital, prevent drug trafficking, or effectively address the climate problem.
>
> (Birdsall 2014)

So at all levels of governance in public and private organizations, there seems to be disarray amplifying and reinforcing many dynamically interrelated changes in every sphere. The changes referred to include such things as changes in global political power blocs which are shifting eastwards, Gen Y socio-cultural norms 'coming of age 'as that demographic begins to access positions of influence, causing new locus of control and focus of leaders' attention.

It is commonplace, therefore, to state that the nature of organizational, commercial, political, and social governance is changing rapidly and that this makes planning for anything other than routine events challenging to say the least. In part the impact and complexity is due to the pace of groundbreaking changes in particular new, crossover sets of industries and technologies. Specifically sociodigital technology and related "BNIC" (biotechnology nanotechnology information and computing) and "GRIN" (genetics, robotics, information, and nanotechnology) technologies increasingly integrated into production of goods and services (Smith and Cockburn 2013, 143). The scope and rapidity often poses governance challenges for various commercial, ethical, religious, and cultural reasons.

> The telephone took 76 years to reach half of all US households. The Smartphone reached the same level of penetration in less than a decade.
>
> (PWC 2014, 12)

Lee Rainie, director, Pew Research Center's (March 13, 2014) "Internet & American Life" Project stated on a discussion on the Diane Rehm show, NPR, about "The Future of the World Wide Web" that "Experts believe the internet is becoming kind of like electricity in people's lives: more important, more powerful, more embedded in the rhythms of their lives, but less visible". However, there are still some threats to the transparency and accessibility of the Internet as noted in later Pew Research in July 2014 (Anderson and Rainie July 3, 2014).

So organizations of all kinds are facing unprecedented demands that they must be successful in growing their business niches while also operating in increasingly dynamic contexts and under ever escalating ethical, safety, or regulatory constraints. In face of these challenges, "business as usual" is not a viable option, and organizations must change or die.

Not only are there changes in production, distribution, and sale of goods and services but also in their consumption and in other fields such as the use made of these goods and services as well as the nature of ownership. Many are now beginning to move away from ownership of goods such as movies and music reproduction and toward streaming to your device. In that case, the ownership of the product remains with the producer who streamed it to you, unlike CD or DVD purchases for example. On the other hand, this has inventory risks and insurance costs.

In parallel, we have witnessed a rising trend in corporate collaborations globally, increased monetization, and "shareability" of personal assets among groups of "prosumers." Beyond wikileaks and other whistleblowing, the wider public accessibility of information has generated greater demands for deeper scrutiny and wider accountability or regulation of business practice at all organizational levels. In the wake of the "bailouts" for banks such public expectations have become the norm (Toffler and Toffler 2006; Smith and Cockburn 2013; Nielsen 2014).

In the developed countries and in some industries in the emerging nations, an overarching trend of note is that smart machines continue to takeover more of the routine, repetitive work and tasks previously carried out by unskilled labor. This means reducing employment openings for some in the labor market, though possibly also enabling the enrichment of work for others. The labor reduction trend that has accelerated after the financial crisis of 2007/2008 is now also beginning for professional and skilled work (Davis et al. 2005; Arthur 2011; Ashkenas and Parlapiano 2014; Smith and Cockburn 2014). However, it would be glib to assert that the more positive gains from technological impact are globally true at this time.

Governance and a Mirror Cracked

Cultures reflect societies, organizations, and individuals' beliefs, values, and how they view the world. Digitization, Web 2.0, and other technologies reinforce and amplify focus on some aspects of governance more than others often prompting broad culture changes both locally and globally as well as revised corporate capability. Some of these new corporate sourcing or supply chain relationships, for instance, are reflections of the history of power differentials between large corporations and the poor countries in which they operate.

The new technology reinforces the historical business drive to reduce the marginal costs of production in order to increase corporate capability and become or remain competitive. Today that process means these less developed regions' competitive advantage (plenty of cheap labor) drives them to run ever faster simply to stand still. The "offshore" facilities or suppliers must strive even harder to compete as least-cost production facilities in the global market. Figuratively, the drive is akin to Sisyphus' punishing task of continually having to push a boulder uphill only to see it roll down again. That is, they battle against the recurrent waves of reductions in marginal costs available from applications of new technology to firms in the first world (Rifkin 2014).

At the microlevel of individual organizations or people, it is clear there are still many incidences of exploitation including child labor, debt slavery, environmental degradation, and poor safety standards in low-cost mass manufacturing and other sectors in places overseas as a result. In those areas and industries, the notional potential to free up workers for more stimulating challenges, using technology, is nowhere to be seen. The issue is both governance and management of resourcing issue. Nor is the issue solely one for the "third world" countries and industries concerned. Large multinational enterprises from many "first world" countries are involved in procuring the goods delivered via these same supply chains.

At a macrogeopolitical level, the U.S. government National Intelligence Council (NIC) global futures projection revolves around four scenarios used to examine complex interactions of globalization, demography, the rise of new powers, the decay of international institutions, climate change, and the geopolitics of energy.

The NIC scenarios are summarized as follows:

1. A world without the West: The new powers supplant the West as the leaders on the world stage.
2. October surprise: Illustrates the impact of inattention to global climate change; unexpected major impacts narrow the world's range of options.
3. BRICs' (Brazil, Russia, India, and China) bust-up: Disputes over vital resources emerge as a source of conflict between major powers—in this case two emerging heavyweights—India and China.
4. Politics is not always local: Nonstate networks emerge to set the international agenda on the environment, eclipsing governments. (NIC 2008)

Other regional and national scenarios include the three scenarios listed as follows:

- The "world markets" scenario: A global economy based on high levels of international, "light touch" regulation and cooperation, reflecting a world of internationally coordinated policy framed within an ideology of "minimal government" (Department of Trade and Industry 2002; U.K. Commission for Employment and Skills 2008).
- The "national enterprise" scenario: This is imbued with hints of mercantilism. People and governments seeking autonomy, welcoming liberalized markets as a governance bundle ensuring individual, local, and national self-reliance and security, in a more polycentric world where international cooperation is highly constrained.
- The "global sustainability" scenario: More community oriented and collaborative. This model of a Global Civic Society is a world where people shared values and consequently shows a higher level of potential for international cooperation with market regulation to ensure fair competition.

Some authorities say that a complex, polycentric world has already emerged with the Chinese and BRIC nation's political and economic spheres of influence now superseding that of the U.S. or Russian influence. In particular, it is argued the changed power balance has occurred in some regions such as those of Latin America, Africa, and the South Pacific (Armijo, Katada and Wise 2011; Lachman 2014).

Lachman (2014, 197–8) further asserts that the crux of these changes revolves around the growth in local skills of financial statecraft and a "tainted" history of former business support for U.S. foreign policy between 1960 and 2010 as much as it is due to political statecraft, power, and influence. His argument is also supported by parts of Armijo et al. (2011) study illustrating growth in the influence of the G20 summits overtaking the G7 following the financial crisis of 2007–2008.

On the other hand, such reconceptualizations are not without their critics who basically argue that the ideas are overblown, exaggerate the small changes occurring, or ignore other longer-term perspectives and evidence contradicting the views about diminishing U.S. influence and power (Shirky 2011). Or in some cases, that the opportunities to effect changes and rebalance power and influence are being squandered, as Chin suggests (2010):

> In the wake of the global financial crisis, the sheen may be wearing off the G20 leaders process. Advisers have begun to warn that the opportunity afforded by the global crisis to transform relations between the traditional powers and the emerging powers, push through needed reforms of the international financial institutions and implement the G20's plan to rebalance the world economy is being squandered. Frustration inside "the 20" has been mounting over the slow pace of progress on global macroeconomic adjustments, prompting warnings of future crises and continuing low growth.
>
> (Chin 2010, 693)

Surprise and Complexity: The Key Business Context of the Future

The current business environment, regardless of the business and technological systems involved, is an environment where a myriad of small elements/events spontaneously interact to produce surprising results. This process is not directed or controlled by any agent or subsystem inside or outside of the system. This "Emergence" is the way complex systems and patterns arise out of a multiplicity of relatively simple interactions. In many ways similar to the "viral" posts on the World Wide Web, change is amplified and spreads as if by an infectious communicative contagion.

Sometimes people are their own worst enemy when trying to understand and navigate a path through periods of turbulent change. The selected frames of reference used in the PR stories or narratives, which organizations and their leaders try to create or to communicate to others, may serve to shutdown possible alternative paths to achieving goals. Thirty-five years ago, Donald Schön stated ". . . social situations confronting us have turned out to be far more complex than we had supposed, and it becomes increasingly doubtful that in the domain of social policy, we can make accurate temporal predictions, design models which converge upon a true description of reality, and carry out experiments which yield unambiguous results. Moreover, the unexpected problems created by our search for acceptable means to ends we have chosen reveals . . . a stubborn conflict of ends traceable to the problem setting itself" (Schön 1979, 144). Confusion, misunderstanding, and misdirection increase as the pace of discontinuous change accelerates the complexity of our situation. The problems of governance are multiplied and entangled in a web of dynamic interactions between agents, principals, and diverse other stakeholders.

Static models of Politics, Economics, Society, Technology, Environment and legislation (PESTEL) or Strengths, Weakness, Opportunities and Threats (SWOT) type commonly applied in teaching of business studies fail to reflect the dynamic risk and opportunity aspects anymore and even scenario planning can be "wrong-footed" by a chaotic "butterfly wings"-type situation eventuating from ripple effects emerging from such small perturbations rapidly communicated across organizations, markets, industries, and countries. The web and the plethora of relatively inexpensive communication devices, intuitive software applications, and the younger generations of "digital natives" regularly posting to numerous social networking websites are vectors of almost instantaneous global transmission.

Pew Global Researchers (2014) have stated that 20 percent of the world has regular mobile and online access, which has reinforced other social and political or cultural demands in particular from the younger generation. As the report states:

> Majorities in 22 of 24 countries surveyed say it is important that people have access to the Internet without government censorship. In 12 nations, at least seven-in-ten hold this view. Support for Internet freedom is especially strong in countries where a large percentage of the population is online. And, in most of the countries polled, young people are particularly likely to consider Internet freedom a priority.
>
> (Pew Global Research Center March 19, 2014)

However, as we inhabit a world rich in digital resources, there is an acute shortage of leadership competence with respect to exploring and exploiting these resources. This creates a key block on further progress in many areas of life and work. So surprise on the part of many in leadership positions could now be said to be a significant or key factor in change. Consequently, governance by extrapolating from the specific, known, or current case history or from previous situations and leadership experiences is a contributory element to their surprise when things go awry.

For instance, the concept of personal ownership of consumer goods is undergoing change and this has an impact on how the economy, businesses, and markets are organized. Nielsen polled over 30,000 online consumers in 60 countries across the Asia-Pacific, European, Latin American, Middle East, African, and North American regions on their willingness to support the growth of a sharing economy. In a "share economy," sometimes called collaborative consumption and peer-to-peer rental arrangements, the consumers rent or share items that they already own, e.g., furniture, cars, homes, or services they have, to others for a profit. Recent news reports indicate the sharing economy is on the rise (Rinne 2014).

About 68 percent of the Nielsen Global Survey Respondents were willing to share or rent personal items; two-thirds likely to use products and services from others and Asia-Pacific respondents were the most receptive to share communities; with 81 percent likely to rent items from others. In Latin America and the Middle East/Africa, 70 and 68 percent of respondents, respectively, are willing to share their personal property and 73 and 71 percent, respectively, are likely to rent products from others. This has potentially very wide impact on many current businesses, e.g., on manufacturing, inventory, pricing policy, marketing, recycling, and sustainability.

However, the Nielsen survey also stated that almost 7 of 10 respondents (69 percent) use the Internet to share their feedback, and the majority of these respondents (54 percent) use social media as their primary their "go-to" platforms to get others' opinions, voice complaints, and so on compared to one-third (32 percent) who use manufacturer websites and 30 percent giving feedback on retailer sites (Neilsen 2014). Chappuis et al. (2011) record seven distinct groups of sociodigital media users. For those aged 34 and under Facebook is their preferred digital communications channel, though smartphone e-mailing is a rising contender (Facebook Statistics 2011; Digital Buzz 2011). Chappuis et al. (2011) also discovered that 33 percent of people in that under 34 age group also get purchasing decision information by using Facebook links and from Facebook friends' recommendations for music (Trendwatching 2011).

Despite the rigorous methods in the Neilsen research, such consumer survey data have been questioned as they often involve people reflecting on, and answering questions about what they may choose to do in future or respondents may seek to provide "acceptable" answers (Devinney et al. 2006). Yet such respondent issues cannot be held to substantially affect the broad underlying sweep of trend data and corroboration of the widespread access and use of such media can be obtained in other ways. The number of people following Twitter postings from companies soared by 241 percent in 2011, compared to 2010, and 84 percent of the top 100 companies in the Fortune 500 have more than one social networking site (Sung-Min 2011; Smith and Cockburn 2014). There are a number of surveys by nonprofit bodies, government, professional, and academic authorities that have produced similar profiles of the extent and pervasiveness of social media usage today and significantly of sales of various web-capable devices such notebooks, tablets, and smartphones have rocketed, not only in the West but in other parts of the world (Smith and Cockburn 2013).

Ubiquitous sociodigital networking increasingly affecting all demographic groups, in many geographic locations, provides exponentially greater information access than before. This further leads to more frequent updating of business data and revisions of opinions to match. In turn, that pace and complexity leads to amplified cycles of unpredictability and "emergence." This has given rise to a new professional discipline and practice of Big data analytics, widely employed by businesses and governments. That was ushered in by the "second machine age": part of the opportunities and issues of the invisible "second economy" of machines and the "Internet of things" (Arthur 2011; Smith and Cockburn 2013; Laseter 2014). As the foreword of the PricewaterhouseCoopers (PWC) 2014 report states:

> We believe organisations must overcome three particular challenges in their race to become fit for the future. They'll need to harness technology to create value in totally new ways; capitalise on demographic shifts to develop tomorrow's workforce; and, just as important, understand how to serve increasingly demanding consumers across the new economic landscape . . . CEOs recognize that as these trends unfold, the demands placed on them will increase exponentially.
>
> (PWC 2014, 1)
>
> Later, on p 10 of the report authors comment that
>
> The digital revolution has put more power in the hands of more people than ever before. Collaborative networks are replacing conventional corporate modes of operating. Consumers are swapping information and advice on the virtual airwaves. And citizens are assuming the journalist's mantle.
>
> Meanwhile, demographic shifts caused by slow—or no—population growth in some countries are causing a massive redistribution of the world's workforce. And since work is what generates wealth, that will have a huge bearing on future consumption patterns as well.
>
> (PWC 2014, 10)

Hence, although the number of interested and "tech-savvy" CEOs in the current generation has grown as indicated earlier, from 23 to

30 percent that suggests 70 percent remain unengaged and that is a concern. The opportunities and threats posed by this emerging technology can no longer simply be ignored by leaders on boards of corporations, government agencies, or committees or left solely to the technical department. As de Stricker (2014, 4) comments: “The increasing sophistication and scale of the systems organizations use to manage information objects and to amass, manipulate, visualize, and extract data have added to the stresses the organizations experience in dealing with their knowledge.”

The use of mobile telephony is widespread even in otherwise undeveloped regions and where there are serious conflicts going on, e.g., in the Middle East and many places in Africa. What has become clear, however, is the increasingly “porous” nature of most modern organizations as “inside” and “outside” blur due to the access and the “democratizing” global impact of digital technology and social media. Combined these technologies are enabling staff, customers, voters, or other stakeholders to reach leaders within their offices and to make them accountable (Willis 2010; Kellerman 2008, 2012; Smith and Cockburn 2013, 2014).

Borders of Accountability and Stewardship

These enhanced communication and other technologies driving greater economic integration of the business world are also weakening aspects of national sovereignty and nations’ power-to-act beyond their home territory in certain respects. The world has seen the growth in the use of mobile technology and social media to effect political, economic, social, and other changes, even in regions without much sophisticated technological infrastructure (Shirky 2011; Robertson 2012; Smith and Cockburn 2013; Smith 2014). There are many examples of mass protests some over a period of years (often similarly organized, using social media) against corporations and governments, such as anticorruption, anti-Wall street, antiworld cup expenditure, and other movements in the EU, United States, Egypt, Middle East, Brazil, India, Russia, and elsewhere (Shirky 2011; Smith 2014).

> Activists in both repressive and democratic regimes will use the Internet and related tools to try to effect change in their countries,

> but Washington's ability to shape or target these changes is limited. Instead, Washington should adopt a more general approach, promoting freedom of speech, freedom of the press, and freedom of assembly everywhere. And it should understand that progress will be slow. Only by switching from an instrumental to an environmental view of the effects of social media on the public sphere will the United States be able to take advantage of the long-term benefits these tools promise—even though that may mean accepting short-term disappointment.
>
> (Shirky 2011, 9)

Beyond the strategic and intended outcomes and governance, there are many instances where the unexpected arises. For instance, Shirky (2011) refers to the unintended politicization of teenage fans of the South Korean boy band DBSK in 2008, leading them into protest action over U.S. beef imports (Shirky 2011, 7). That moral outrage and politicization occurred through seemingly unrelated threads in conversations on the band's fan website. He gives several examples of the deliberate, the unintended, or "casual" politicization via social media in the same article.

These events would also seem to suggest a significant public preference for national, local, or global governance and business with integrity as well as freedom of speech. On the reverse side of the coin, the use of social media promoting terrorism poses a major security threat that cannot readily be curtailed by propaganda and censorship as recent events in the Syrian conflict illustrate. These changes not only exhibit aspects of ongoing paradigm and power shifts globally but also reflect parts of the rationale for our interest in governance, namely, the increased visibility and accountability of business and governments to populations with access to critical or skeptical viewpoints to contradict propaganda and to raise awareness or initiate campaigns for change using the World Wide Web as a platform.

This confronts us with the issue of moral integrity and "ethical capital" of organizations, which is assuredly a core component of governance at all levels. Elsewhere, thus, we have defined ethical capital:

> Ethical capital might be described as the accrued differences between the goodwill "assets" and perceived moral liabilities of an

> organization as expressed in the coevolving relationship of customer loyalty and manifest employee integrity.
>
> (Cockburn, Jahdi and Wilson 2012, 5)

Younger demographic groups are in a majority in the emerging nations and globally as compared to the aging "advanced" economies and we can expect to see an increase in numbers of CEOs from emerging countries who lead Fortune 500 corporations by 2050 (McKinsey 2014).

Interest in BRICs and the so-called next 20 has varied according to the McKinsey survey (2014). As may be expected, there are diverse perspectives on where the next global growth spike will occur. There is a growing interest in some places in Africa and forecasts of growth and development there. These range from Robertson's (2012) optimistic forecast for Africa to economist Ayittey's (2005, 2007) impassioned calls more African style free trade liberalization, less government and for those young, fast-moving, net-connected, and passionate "Cheetah generation" to rescue the continent from the clutches of the "bloated, greedy and deadly 'Hippos.'"

Robertson, commenting on his coauthored book *The Fastest Billion*, states that Africa:

> . . . is going to go from a $2 trillion economy today to a $29 trillion economy by 2050. Now that's bigger than Europe and America put together in today's money. Life expectancy is going to go up by 13 years. The population's going to double from one billion to two billion, so household incomes are going to go up sevenfold in the next 35 years." He also states that the impact of Chinese investment is dwarfed by that of Western countries' FDI, ". . . 60 percent of the FDI in the last couple of years has come from Europe, America, Australia, Canada. Ten percent come from India." In part, he sees technology as an empowering socioeconomic factor in the growth with potential to accelerate development of the Central, eastern and Southern regions especially (Robertson 2013).

In summary, we see an increasing pace of change as the integration of global supply chains and businesses facilitated or enabled by new digital and other technologies grows. Such dynamic complexity is not solely determined by technology, and we must also be cognizant of core enabling political, economic, social, legal, environmental, and cultural factors in the global business and governmental context. Such factors are adding many constraints as well as many new opportunities for the people of the world to advance and to exit poverty traps.

Evolving stories of governance and change are being written into the emerging custom and practice of organizations. These reflect new ways of analyzing, identifying, and framing problems and behaviors for the current epoch. This kind of storytelling has been in existence for many years, of course, as the 1979 quotation from Donald Schon (above) suggests.

Chapter authors discuss a number of complex emerging relationships and themes of corporate social responsibility, stewardship, and other more diverse elements of significance. Three broad headings emerge in various guises. In summary, these are as follows:

- Capability: In technological, organizational, economic, political, and other infrastructures;
- Will: Desire for change among actors, state versus free-market or other interventions, follow-up and follow-through in terms of change and development of local, regional, and global paradigms, purposes, and policing of laws as well as bridging of historical–cultural gaps; and
- Focus: Government, business or industry sector, education systems, structural configurations, stakeholders, and professional practices.

Concluding Summary

The global sweep of the book covers a full range of business and national typologies, moving from developed economies such as the United Kingdom, Scandinavia, Northern America, Australia, and New Zealand through Western European countries, then East via Kazahkstan, India, and southward on to emerging regions of Africa including Nigeria, Ghana, and South Africa.

The global financial crisis has triggered an increasing state presence in many developed and emerging countries following the perception that "too-big-to-fail" bank bailouts were needed; to such an extent that RBS in the United Kingdom is now effectively 80 percent "nationalized." In such cases, the state has become a principal institutional agent as well as a regulator, which some see as a potential conflict of interest. In emerging economies, state-owned enterprises and sovereign wealth funds are increasingly important not only nationally but also acting on a global scale.

We have included a set of chapters on Ghana and South Africa, seventh and fifth placed, respectively, in the 2014 IIAG (Ibrahim Index of African Governance) as examples of potentially up-and-coming exemplars from Africa. Much of the empirical as well as analytical work on CG to date has simply assumed first world models of governance currently in existence in stable and mature economies are the relevant global paradigms. CG issues and challenges facing many organizations and governments in developing countries are, however, quite different to those in more advanced economies. Thus, best practices derived exclusively from research, custom, and practice in the developed countries and economies or markets are seldom as effective in emerging markets contexts. As noted by others, such differences ". . . are not necessarily deficiencies or institutional weaknesses, but are largely related to structural features of ownership and control that are different than most developed countries" (Ararat, Claessens and Yurtoglu 2014).

The chapter authors are not arguing here that the countries shown are "beacons" of best practice or of progress but that they may provide readers with some insight into the hurdles yet to be overcome by nations aspiring to improve their situation. As the authors of the Emerging Markets Corporate Governance Research Network (EMCGN), first 10 years report on CG state

> As various crises reveal, CG is a work in progress not only in relation to emerging markets but also in relation to developed markets and will remain so in the foreseeable future. It is thus all the more important that the transfer of knowledge, which has been largely unidirectional to date, travelling from developed to emerging markets, should flow both ways. First of all because emerging markets have come of age where governance is concerned. They have accumulated significant know-how and experience in improving corporate governance. They have developed novel approaches to CG issues. Second, there were, and continue to be, many failures in

> the oversight and performance roles of regulatory and supervisory agencies in advanced countries. There is much to be learned from CG research in general, and specifically from emerging markets, which can be useful lessons for advanced countries.
>
> These chapters are thus presented as a means of benchmarking progress in governance as well as issues and the impact of the latter in the more stable areas of the continent.

Précis of each of the succeeding chapters are set out as follows.

Chapter 2 by Graham Oakes and Martin von Weissenberg is titled "Governance and Agility in Product Development Organizations." These authors are based in the United Kingdom and in the Nordic region, respectively. They consider the complex outcomes and impacts of technology and globalization on social norms of consumers and citizens, which, they argue, are rapidly and continuously changing. Likewise, they discuss how the capabilities of potential partners and competitors are also constantly shifting and realigning. The evolving contexts thereby generated necessitate organizational and systems changes and disruptions. Complexity in one domain amplifies and intersects with dynamic changes in another. Thus, business governance sets the terms for allocation and legitimate use of power, which also mandates developing strategies for dealing with uncertainty and complexity involving the organizational redistribution of power specifically in product innovation. Paraphrasing the authors' introduction, we can say that whether public, private, or not-for-profit organizations exist to deliver products and services to customers, citizens, or other stakeholders. As the world transforms toward an information society, customers have more information and can make better buying decisions on price and quality, but differentiation through product and service innovation characterized as a complex, emergent process is increasingly important for continued survival.

The chapter examines these questions and related matters from the perspective of organizational agility: how does effective governance support an organization to create and learn from change while rapidly creating value for the customer? The authors provide illustrative case materials and discuss a range of key theoretical debates and models for readers on the role and significance of governance in such porous organizations and industries exhibiting forms of cultural clash as one of the impacts of new cross-organizational forms with nontraditional decision making such as crowd sourcing. They proceed to conclude with reasons why governance matters and present readers with some useful suggestions for governing agile organizations built upon models such as Snowden's Cynefin model (2012).

Chapter 3 by Roopinder Oberoi is titled "Rebooting Corporate Governance in India: Understanding the Journey through Institutional and Regulatory Landscape to the Landmark Companies Act 2013." The chapter is based on (1) a diagnostic review of the legal and regulatory framework for CG; (2) the findings and recommendations of various commissions and expert groups appointed by Government of India (GOI) on CG; (3) underscores the distinctiveness of CG in India; and (4) spotlights on governments guidelines for sustainable development and mandatory clause of Corporate Social Responsibility (CSR) allocations and governance in the Companies Act 2013. This is indeed a epoch-breaking provision of the act as India becomes the first country to take away CSR and sustainability from the zone of voluntarism to embed it in compliance/mandatory clause. This chapter aims at going beyond description and appraising India's CG efforts to make business accountable and assess the noteworthy slips in the enforcement of the regulations. It makes an assessment of the complex legal and institutional aspects of investor protection and CG in India—both the letter of the law and the reality of its implementation.

Chapter 4 by Shafi Mohammed and Mark Toomey is titled "Importance of Enterprise Technology Governance in Effective Corporate Governance." The authors, based in Australia and the United Kingdom, take a global view of technology and governance. This chapter analyzes some of the different definitions of CG as well as the importance of CG. It then examines the core components that contribute to effective CG by looking at the model developed by the Organization for Economic Cooperation and Development (OECD) Business Sector Advisory Group on Corporate Governance or more commonly known as the Millstein report. Next it goes on to discuss the importance of efforts to raise the awareness of CG globally, keeping in mind the differences in national cultures as well as differing social and economic priorities between sovereign nations. Finally, it considers some of the key questions that boards ought to raise with their management in this digital era. This would enable them to carry out their role as stewards effectively and thus enhance their practice of CG. It then concludes by stating that at this point in time, a consensus on a single model of CG is both unlikely and unnecessary as over time the exigencies of the capital market (market forces) will lead to increasing convergence in practice between countries.

Chapter 5 by Yan Pomare and Anthony Berry is titled "Responsible Governance and Financial Accountability: International Perspectives for the New Era." In this chapter, these authors focus on the overlaps and gaps between the themes of perceived changes in the external and internal strategic environment of the nonprofit higher education industry in Western Canada, specifically on Alberta and British Columbia. They carry out a comparison of external and internal strategic analyses and "hard" versus "soft" management control systems, related to the financial accountability systems as decreed by government and political parties in power. The authors complement these comparative analyses with reference to the organizational culture within higher education institutions in Western Canada as a governance case study. Each of these overlaps and the first academic debate explored in this chapter is related to the higher education industry in Western Canada. It explains how it has shifted on external and internal strategic dimensions of governmental and political rules. That is toward competitive markets and altered organizational culture (i.e., external and internal strategic analysis) resulting in a more managerial approach to the industry. The authors argue that the literature illustrates that strategic management by the board of governors and executives does not necessarily help dealing with the high level of complexity of the external and internal strategic environments. As such it does not necessarily improve organizational performance. They further suggest that the impact of governance and executive leadership on organizational performance is modest at best. They present their empirical case research data to corroborate their commentary and conclusions regarding the effectiveness of boards of governors in the industry.

Chapter 6 by K.Ogunyemi and B. Nwosu is titled "Building Trust for the Internal Stakeholder—Governance Footprints within the Organization." Literature on CG has usually focused on two stakeholders—the owners and society. Stakeholder theory, however, includes other stakeholders. There is still considerable variance across the developed and industrialized world in terms of expectations of governing boards, their roles, and what they must address.

Although countries such as the United Kingdom have eschewed mandatory governance requirements specifically referring to staff, since these areas are covered in other legislation such as the Health and Safety at Work Act. Other countries such as Germany insist organizations include employees in works councils and yet other regions have no clear or enforced requirements beyond ensuring taxes are paid. A key question then is "What would be the content of CG that is directed toward employees?" This qualitative study brings the principles of CG into a conversation that would ordinarily be framed by employee–organization relationship (EOR) theory. The study examines the social capital and relational components as well as the formal processes, systems, and implementation of governance norms, policies, and actions, comparing and contrasting the case organization's approach to more "typical" ones in the hospitality industry in Nigeria.

Chapter 7 by R.Makarov, N. Orazalin, and M. Mahmood is titled "Corporate Governance and Voluntary Disclosure: A Study on the Banking Industry of Kazakhstan." This chapter concerns an emerging nation in the former Soviet Bloc. Although many have studied the topic of voluntary disclosures in both developed countries and in emerging markets, there is no such study on Kazakhstan. As the writers state, "Transparency, accountability, and good governance have become imperatives for publicly listed companies after the recent accounting scandals and financial debacles Corporate disclosure plays a crucial role in mitigating information asymmetry and reducing agency problems . . ." In this chapter, the authors present their research reviewing bank governance in an emerging nation. They examine the scope of voluntary disclosures locally and consider the determinants of these voluntary disclosures as well as their relationship with the CG aspects of banking companies in Kazakhstan.

The quality of information provided by corporate companies in their annual reports, however, has attracted considerable interest among scholars, regulators, and market participants. As a consequence, the authors state that companies face immense challenges in trying to meet the increased demand for transparency and good governance. Kazakhstan has systems that are hangovers from the former Soviet era and in need of change and development the authors note. To update and improve matters, the Government of Kazakhstan developed a Code of CG in 2005 and declared it mandatory to joint stock companies (JSCs) to follow the guidelines stipulated in the Code.

The authors conduct a literature review and then discuss their methods and empirical data before moving to review findings. They then discuss their conclusions and some policy implications. They consider the newness of this in terms of the social culture in the post-Soviet era and suggest some policy and practice implications regarding size, numbers of internal versus outside board members derived from their findings, and the national aspirations to be one of the top 50 most competitive nations by 2020.

Chapter 8 by Christopher Boachie is titled "Corporate Governance Disclosures and Firm performance." The study examined the effect of CG on the performance of firms in developing economies by using both market- and accounting-based performance measures. The study made use of a sample of listed companies from South Africa and Ghana for short descriptive cases, scenarios and vignettes. It adopted an in-depth, exploratory approach in reviewing the CG issues from the perspectives of principles, regulations and performance of the top firms.

Chapter 9 by C. Rigby and L. Fortune is titled "Disaster Governance—Dealing with an Earthquake." This chapter considers how unexpected events unfolding in real time require specific forms of collaboration and governance. Organizations operating in environments where natural disasters occur need to take account of governance issues when dealing with a crisis, particularly when the organization, staff, and its clients may all be affected. One organization, Pathways, which offers mental-health services, has reviewed its disaster governance during the February 2011 Christchurch earthquake. Feedback has been examined thematically in terms of strategic intention (including business continuity), human resources issues (including deployment of staff), organizational culture (including lived values), and strategic networking (including organizational politics and links with external organizations). Learning from the earthquake includes the need for responsive and visible leadership, effective information and communication systems, interagency collaboration, role clarity and boundaries, robust selection criteria, and enactment of the organizational values.

Chapter 10 by G. K. Amoako is titled "The Role of Corporate Governance in Business Performance in Ghana." This chapter seeks to demonstrate how CG activities have influenced business success and how business success can be maintained through good governance in Ghana. It also seeks to ascertain and document how regulation can help shape governance issues in industry. It further examines the extent to which the nature and content of governance actions in Africa differ from Western and other economies in the world.

Chapter 11 by R. K. Dzogbenuku and V. A. P. Dzogbenuku is titled "Corporate Governance and Microfinance in Ghana: A Qualitative Insight of Key Stakeholders." Their study of a particular industry associated with development sheds light on the issues and problems of ensuring good governance for nations trying to build their economies while helping people out of poverty. The study revealed that microfinance institutions (MFIs) need to operate under stringent CG policies enforceable by regulators. The managerial implications are that MFIs operating in developing countries ought to appoint experienced professionals with a background in marketing, finance, human resource entrepreneurship, and law. This would enable them to champion the cause of microfinance operation to benefit the customers, employees, and investors. Considering inherent limitations of case study, other research approaches have been recommended for future studies.

Chapter 12 by A. de Chiara is titled "Multistakeholder Committee for Sustainable Innovation: Creating an Ethical Code in the Jewelry Business. The Experience of the Italian Ethics Committee of Color Gemstones (Assogemme)." This chapter concerns complexity of the accelerating and enabling innovation and sustainability arrangements between firms for collaboration between them involving the exchange of resources of skills and knowledge. The author views the core of these relational and network processes as forming a central component of stakeholders' engagement in solving a shared problem requiring participants to share information and have a constructive dialog.

Increased complexity of knowledge and new production processes are the backbone of new technologies and innovation. Therefore, firms often must complement their currently available supply chain for building a sustainable skills and knowledge base by sourcing extra capabilities from outside the organization and staff. This can be a costly process if extra staff members are hired. However, sharing resources between two or more organizations for short- or longer-term innovation projects could defray costs.

The author discusses a number of innovation cooperation strategies used by small, medium, and large organizations. Participation, sharing, organization, and coordination are essential to accomplish an act of collaborative sustainability. The aim is to create a "learning alliance," in which a range of stakeholders—typically located at different levels and within different domains but connected by a common interest in promoting inclusion—come together as a group to optimize relations and break down barriers to learning.

The empirical case material is based on the gold and jewelry industry in Italy. In this sector, there are many ethical, environmental, and cultural issues to contend with in building and consolidating a functioning, multistakeholder arrangement as described earlier. Thus, it is useful and instructive to discuss empirical research on the working arrangements of the Ethics Committee of Color Gemstones, Assogemme, and related aspects of leadership and governance in the industry.

Chapter 13 by N. Sivakumar is titled "Understanding Ethical Governance through the Principles of Responsible Management Education—A Literary Study." In this chapter, the objective of the author is to analyze ethical governance through the lens of the UN Principles of Responsible Management Education (PRME). The chapter adopts a novel methodology of conducting a literary study of two iconic plays, one each from the Eastern and Western worlds and uses key principles from PRME as a foil against which he compares the literary texts and ideas of the respective authors, noting how to some extent "life imitates art" at times and in terms of these long-held ethical principles upon which plot and characterization are developed and framed as lessons or parables.

He begins by recognizing the changing scene in global business today, noting altered expectations and stakeholders as well as technology. He briefly discusses and gives an overview of the grounding of the comparative methodology he intends to deploy referring to material drawn from the business and research domains.

He engages in a dialog with these famous and iconic cultural works and how they might be called upon even today as a sound base for the education of managers and for constructing the governance "story" of organizations of all sizes. The chapter concludes with some lessons for ethical governance based on the tried and tested values underpinning the legendary wisdom, compassion, and understanding of people and systems shown by the mythical characters of leaders and participants in each story.

There is a deeper message underpinning this extended literary metaphor and use of the analogy of the two cultures of east and west. In part, the message concerns the extent of globalization and individual's proximity to each other in terms of accessibility via transport systems and through use of Internet and other communication systems. These systems are not solely channels for business or personal communication but also include cultural interchanges that occur as indicated in earlier. Here the author draws out that point in an interesting way, highlighting commonalities that stretch across centuries and may be utilized to good effect in building and narrating sustainable management education stories about international business relations and education.

In Chapter 14 by Tom Cockburn, Khosro Jahdi, Edgar Wilson "Postscript: Board dynamics, market turbulence, knowledge asymmetries and Long-term Structural Relationships," the book's editors review the diverse chapters and draw out some common threads and areas for future research.

This book deals with a range of perspectives and points of view on the core topic of governance in the emerging digital era that is still unfolding and evolving new aspects as we write. There are a many disparate and interrelated themes, which authors have tackled, which have been briefly outlined here. They include organizational, business, and governance complexity and the ensuing impact of various sociocultural lags or in some cases simply leaders' misplaced nostalgia for "the way things were." That nostalgia is now firmly in the predigital past, a time before the dawn of the do-it-yourself democratization via sociodigital technologies increased the ability of the public to break the former business or government control of who might access information, leaders.

Tom Cockburn obtained his first degree with honors from Leicester University, England, both his MBA and Doctorate were gained at Cardiff University, Wales. He has several professional teaching and assessment qualifications, including e-moderator certification and executive coaching qualifications from UK Universities and Professional bodies as well as from the Waikato Institute of Technology (New Zealand) and Hay Consulting (Australia). Tom is Associate Fellow of the New Zealand Institute of Management and has experience on a number of editorial boards of academic journals, and review member of the Cutting Edge Awards Committee of the US Academy of HRD. He has 5 years Board experience on the Standing Conference of Welsh Management Education Centers, one year as a non-voting Trustee in K'aute Pasifika Board, New Zealand and has carried out a number of Institutional Teaching audits in the UK. Tom has 8 years senior academic experience as Head of a UK Business school and a deputy Head of School role in New Zealand as well as adjunct and visiting E-faculty roles on Henley Business School (UK) and Ulster University Business Schools' MBA and MS programs. He is currently Director, Policy, for the Center for Dynamic Leadership Models in Global Business founded in 2012. Tom is also co-author and co-editor respectively (with Peter A.C. Smith) of *Dynamic Leadership Models for Global Business: Enhancing Digitally Connected Environments* (2013) and in (2014) *Impact of Emerging Digital Technologies on Leadership in Global Business,* published by IGI Global.

Khosro S. Jahdi

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Edgar Wilson, JP, has considerable experience on Trusts in a range of governance roles. These present roles include Deputy Chair and Trustee of First Credit Union with a membership of 58,000, Deputy Chair of Trust Waikato, Deputy Chair of K'aute Pasifika (a Pacific Health Provider) and elected member of Independent Tertiary Education New Zealand Board.

As well a raft of leadership experience and expertise Edgar has presented at a number of conferences both national and international. The most recent being a paper and presentation at the World Council of Credit Unions) Gdansk, Poland 2012) entitled: **First Credit Union (NZ) case study: Building a culture of integrity-practical tools and techniques**. Edgar is the joint author of a chapter of a book titled **Business Integrity in Practice: Insights from International Case Studies** part of the *Principles of Responsible Management Education (PRME) United Nations book collection.* One of the first books in the UN collection for the PRME series.

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Study Questions

1. Which came first—"Chicken or egg?" Some suggest that an enabling cultural capability, with a will to change and a focus on change must precede any change irrespective of technology drivers.

2. It is often said that aid donors have focused too much on ensuring democratic governance in emerging countries and not enough on economic development. Is there a pragmatic trade-off between rising prosperity and freedom of speech that aid countries can or ought to focus upon?
3. Should big business leaders govern higher education to ensure a pipeline of the right talent for the “future-proofing” of the national economy?
4. As robots will soon take over many jobs, shouldn’t education be redirected to building a caring society?
5. Read the Amy Ter Har article (see Extra Reading). Should the corporate capability to manufacture social consent be regulated? If so, how could that be done effectively?

CHAPTER 2

Governance and Agility in Product Development Organizations

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Abstract

In a globalized, technology-driven world, consumer and citizen expectations are changing rapidly. Likewise, the capabilities of potential partners and competitors are constantly shifting and realigning. These trends place increasing pressure on organizations to adjust the way they develop new products and services. They must evolve their product portfolios rapidly, while constantly seeking feedback from customers and partners. This may involve substantial changes to organizational processes and boundaries, e.g. opening up innovation processes through techniques such as crowdsourcing. Above all, it requires organizations to deal with uncertainty and complexity. And that requires them to deal with governance, for most strategies for dealing with uncertainty and complexity involve redistributing power within the organization. Governance sets the terms for allocation and legitimate use of power.

This chapter explores the role of governance in product innovation. It examines the benefits of clear governance, both to organizational

effectiveness and to the wider societal good. It discusses people's perceptions of governance. It describes common governance models and the trade-offs they entail. And it looks at these questions from the perspective of agility: how does effective governance support an organization to create and learn from change while rapidly creating value for the customer?

The authors take the perspective of practitioners working within product innovation organizations. They present their observations of the challenges that such organizations are facing (or perceive themselves to be facing), then attempt to place these observations into a theoretical context by reference to models of complexity and agility. They then explore the implications of this thinking for effective governance of product innovation.

Keywords: accountability, agility, change, complexity, crowdsourcing, Cynefin, decision making, governance, open innovation, product development, uncertainty.

Introduction

Most organizations, whether public, private or not-for-profit, exist in order to deliver a suite of products and services to customers, citizens or other stakeholders. As the world transforms towards an information society, customers have more information on hand and can make better buying decisions. Companies still compete on price and quality, but differentiation through product and service innovation is an increasingly important element of their continued survival. Such innovation is often characterized as a complex, emergent process, especially in domains that deal with fast-paced change, rapidly evolving competition and "wicked" problems.

Consider, for example, the case of AB Corporation[1]:

> AB operates mobile phone networks in most European countries, along with the all the necessary supporting infrastructure—service centres to provide round-the-clock support to its customers, retail chains to sell handsets and related services, e-commerce systems, etc.

[1]This case study is derived from our work on product innovation within AB Corporation.

AB constantly needs to reconfigure each of these elements in response to a rapidly changing marketplace. For example, rapid shifts in mobile phone technologies require it to invest heavily in networks. Its service plans must be updated regularly to accommodate shifts in the way people use their phones, new entrants into the marketplace, etc. Partnerships with device manufacturers, retailers, app developers and other partners form and reform as the market shifts. Revenue from “legacy” sources (voice and texting) declines while compensating revenue from data services grows less quickly.

Amongst all this change, the central product development unit decides to develop a new service. It works with a device manufacturer in East Asia to develop new handsets and to tailor their operating system for AB’s customers. It acquires several European app developers to develop customised applications for the handsets. It builds a large in-house team to develop “cloud” services to add value to the applications. The overall target is to provide an environment that will retain more customers in a highly competitive market, and then enable AB to sell more, higher value services to each customer.

Unfortunately, the project to develop the handsets is delayed due to communications problems between the European and Asian teams. The “cloud” service receives poor feedback from initial user testing in several countries. The different app developers cannot agree on a common approach to deal with concerns such as customer data storage and privacy. AB’s operating arms in several European countries refuse to support the new service, claiming that it does not address significant features required for their markets. In markets where it is introduced, customer service operators do not receive adequate training, so cannot sell and support the service effectively. The overall programme is closed down, and rarely mentioned again within AB Corporation.

Forces for Change

This case study is not atypical. In our experience, as practitioners working within product innovation teams in a variety of contexts, organizations around the globe are experiencing (or perceive themselves to be experiencing) rapid shifts in their "marketplace"—whether a commercial marketplace, the citizenry to which a government provides services, or the stakeholders supported by not-for-profit organizations—due to a large number of interconnected factors, the primary factor being *technological change*.

Digital and communications technologies are evolving rapidly, creating new opportunities in the marketplace while rendering existing products and services obsolete. Changes in one area frequently cause cascading changes in other areas. For example, emergence of "cloud" technologies has required new software development approaches and toolsets, and created new affordances for user interface design, while also raising substantial concerns in areas such as security and privacy. It is difficult for organizations to understand the impact of such changes and hence to direct an appropriate response.

This technological change has given rise to *information-driven economies*. Information-centred products offer new ways to create value—customers are prepared to pay for services, for personalisation, for "experiences" as well as, or instead of, physical artefacts. Organizations build further value by connecting and integrating rather than by manufacturing. Much of this value comes from design rather than from capital-intensive manufacturing and logistics, allowing small, nimble organizations to compete on an even footing with larger ones.

Advances in communications technology and medical science interact with *demographic shifts*. Populations in the developed world are aging, creating requirements for new services in domains such as health care, while requiring fresh attention to be paid to concerns such as accessibility. At the same time, younger generations are bringing very different experiences and expectations to the marketplace, e.g. for "always-on" availability of services and support, and for "any time, any where" access to information. These shifts empower some people, but create complications for the organization(s) delivering the services. These complications can in turn lead to added pressure being placed on staff, e.g. to work longer hours or unsocial shift patterns.

Coupled with technological change has been a rapidly *increasing demand in people's expectations* as to what constitutes "good" service.

Customers and citizens expect services to be delivered with ever increasing levels of speed, availability and reliability, with improved user experience, in a personalised way, and at ever decreasing cost. Again, this creates challenges for the organizations providing such services: how can they deliver such high levels of service while also delivering acceptable performance to shareholders, members or taxpayers, and while respecting the needs of staff and suppliers?

In parallel, *global shifts in supply chains and manufacturing capabilities* are taking place. Improved communications and transport technologies have made it easier to coordinate global supply chains, while many countries have built advanced capabilities in product design and manufacturing, service delivery, etc. These capabilities have co-evolved with customer expectations—customers expect more because they see that their suppliers can do more, and suppliers improve their capabilities because they can see customer demand for better products and services—but they also create dramatic power shifts in the supply chain. Centralised, top-down direction is rarely feasible in such complex supply chains, and neither is it acceptable to suppliers that have developed advanced capabilities in their own right. And again, questions of the rights of vulnerable staff within the supply chain arise.

Demographic changes and improved customer analysis methods give *rise to new markets*. Growing sophistication in analysis of customer data allows organizations to identify ever more micro-segments. This fragments the product portfolio, and raises questions about how accountability is partitioned across these often-overlapping segments. At the same time, rising wealth in nations such as India, China and Brazil is focusing attention on "bottom of the pyramid" customers, which central product development teams are poorly placed to understand. Overall, this combination of broadening and fragmenting markets means that it is no longer a case of people in "advanced" facilities telling those in "less advanced" ones what to do, but more one of sharing ideas and learning across peers. It is not clear that traditional corporate governance structures are best suited to such peer-to-peer organizations.

Furthermore, the *capabilities of new competitors and partners are growing*. Many organizations have been founded on the premise that they contain sufficient in-house skills and resources to succeed through tight internal control of product development and delivery. This premise no longer holds. Many trends are increasing the range and capability of potential partners and competitors. For example, advanced information and communication technologies enable small companies and networks of companies to develop new products in very short timespans. To compete effectively, organizations need to work with such emerging organizations, integrating them into their innovation teams and processes. Again, this creates complexities for decision-making and coordination—who within the web of partners has power to make critical decisions; who else must they involve in making these decisions; etc?

In all, this adds up to an *impetus to address ever more complex problems*. Many of the niches for simple products have already been filled—organizations must address ever more complex problems if they are to find a niche for themselves. At the same time, customers prefer conceptually simple solutions that are easy to use and fit neatly into their busy lifestyles. Organizations are left with the conundrum of finding simple solutions to complex problems. This is often resolved by hiding product complexity behind a simple façade, a feat which requires the organization to manage complexity exceedingly well.

Coping With Change

In order to thrive in these new marketplaces, organizations must constantly extend and evolve the suite of products and services that they provide to their customers. They typically do this through some combination of the strategies outlined in this section.

Organizations may attempt to produce a range of *product variants and extensions*, each targeted on a small micro-segment of their customer base. If such variants can be produced rapidly and without complicating and slowing down development of the overall product catalogue, they provide a powerful way to compete in a market that is fragmenting and evolving rapidly. Likewise, organizations may try to capture more value from their customer base by creating value-added services to support their product range. As well as increasing profitability, this can help meet rising customer expectations, but again at the risk of complicating the product portfolio and associated questions of ownership, accountability and decision-making.

Many companies are attempting to *increase the pace at which they deliver new and improved products*. Formerly, companies could spend several years on developing a new product version — recall Microsoft Windows 95, 98 and 2000? Today, a large number of organizations have moved from multi-year projects through regular yearly releases to a quarterly or bi-monthly rhythm, an order of magnitude faster. In the extreme, many web-based service providers now aim to deliver updates to their sites several times per day. This allows them to test new products and hence respond rapidly to emerging customer preferences, to experiment with and learn about new technologies and partners , etc. And again, it creates many questions for control, accountability and decision-making—how is product quality assured in the face of such rapid evolution; who prioritises objectives and resources across multiple parallel streams of development; etc?

Likewise, many organizations are trying to *bring customers and partners into the innovation process*, for example, using "crowdsourcing" to work with citizens and customers to clarify their needs and co-create new services that fill those needs. Thus LEGO is actively nurturing "AFoL" or Adult Fan of LEGO communities, from which it can source ideas for new and innovative designs. Or organizations may bring specialist expertise into their innovation process through methods ranging from setting challenges onto "open innovation" networks to forming more conventional partnerships with specialist firms. These approaches help the organization increase understanding of its customers and expand the range of expertise it has available to deliver new products. Use of lightweight processes such as crowdsourcing and open innovation challenges can also increase the speed with which an organization responds to shifts in markets and technologies. And again, it raises questions of ownership of intellectual property, accountability, the locus of decision-making, etc.

Organizations are also doing all they can to *seek rapid feedback from stakeholders and customers*. Many companies no longer rely on six- or twelve-month product release cycles, but instead aim to test customer expectations then implement and market new products within a few months. Deploying small incremental changes allows them to collect early data about sales and usage, and hence to validate assumptions before committing significant resources. This also enables them to drastically cut their inventory of "work in progress", enabling rapid turn-around and reducing operating risk significantly.

To enable the above changes, organizations are *adopting new product innovation processes* using thinking drawn from domains such as lean product development and agile software development. This typically involves devolving some elements of decision-making to small, self-organising teams, on the assumption that this will increase the pace and diversity of product innovation, allow teams to get closer to specific customers, and make it easier to integrate specialist suppliers into the process. However, "empowering" small teams also raises questions about the boundaries of responsibility and accountability (which decisions belong to the team, and which to managers and executives overseeing them?), setting and coordinating priorities across the organization, allocating scarce resources, and developing and maintaining "corporate" assets (e.g. brand, product line architecture). The plethora of "agile" processes that has been described also raises questions about who chooses which process to adopt, and how to coordinate across different teams if they each choose their own process.

These are all strategies for dealing with uncertainty and complexity—a larger product portfolio gives more chances to find the "sweet spot", as does more rapid introduction of new products; including partners and customers in processes extends the range of skills and perspectives that can be applied to any problem; devolving decision making to small teams enables rapid response to new information as it arrives. The overall trend is to adopt strategies that enable an organization to extend the range of information which it can gather from the marketplace and increase the pace at which it can respond to this information. These are the keys to surviving in an ever more dynamic environment. ("The Lean Startup", Reis (2011), with its emphasis on "pivot points", is a good example of this focus on rapid acquisition and response to information, as is the general shift towards "agile" software development, discussed below.)

Such strategies also change the power structure within the organization. Approval structures built for annual product releases cannot cope with monthly, weekly or daily product increments, so approval power must be devolved to new structures. As revenue shifts from products to services, so power shifts from manufacturing arms to service delivery teams. Each alliance requires some elements of decision making to be shared with new partners. Open innovation processes raise questions about ownership of intellectual property, accountability for product defects, etc. Empowering the team implies disempowering product and project managers, and so on.

Thus effective governance is at the core of product and service innovation. Organizations cannot improve the way they innovate without rethinking they way they govern themselves. The balance of this chapter will look at this question.

Challenges for Governance of Product Innovation

Of course, rethinking the way an organization governs itself is hard. People are rarely keen to give up power they have accrued for themselves within existing structures, and many people may be reluctant to take on unfamiliar responsibilities and accountabilities. Establishing governance structures to support product and service innovation processes runs into many challenges.

For a start, many advocates of "agile" approaches take a negative *attitude to governance*, disputing the very need for it. Equating governance with the imposition of bureaucracy, top-down controls and a culture of compliance, they reject attempts to consider governance and focus their attention on other aspects of change. In doing so, they increase the likelihood that inappropriate governance structures will emerge as an uncontrolled side effect of change. The resulting uncertainty around decision-making and responsibility can reduce the efficacy of the organization significantly.

We also find that different members and units of an organization can have very different **perceptions of governance**. For example companies that are changing rapidly may find that their previous centralised governance structures are no longer adequate, but have little time to think about new ones. The old structures remain in place while mid-level managers define their own local governance structures to get things done. This makes it difficult for people to understand where decisions are made: governance becomes fragmented and opaque, a source of contention rather than clarity.

Adding further confusion, professional bodies with an interest in product and service innovation promote a wide variety of *governance models*. For example, project management bodies such as the PMI (Project Management Institute) and APM (Association for Project Management) promote forms of governance that emphasize "top down" decision-making by steering groups and project managers. Other groups place greater emphasis on self-organization and "bottom up" decision-making. There are few objective sources discussing the pros and cons of these various forms, leaving practitioners in a quandary as to which form will work best in their circumstances.

In addition to the complexities mentioned above, organizations have increasingly porous boundaries. Rather than control innovation entirely within their own boundaries, they often form partnerships with other organizations for **multi-organizational innovation**. This leads to a variety of cross-organizational forms—joint ventures, public private partnerships, special purpose vehicles for specific projects, etc.—that can be difficult to govern, especially when the partners bring very different cultures and decision-making styles to the relationship. The rise of crowdsourcing, open innovation and co-creation with customers further complicates questions about the locus of decision-making and the ownership of intellectual property.

Even without the above complications, choosing an appropriate governance model involves *complex trade-offs*. No decision-making structure gives a perfect combination of speed, flexibility, context awareness, organizational consistency, etc. Centralised control structures, for example, help ensure that common standards are applied across the organization, but also create long chains of command that slow down decision-making and separate decision-makers from information on what is happening "on the ground". Conversely, devolving decision making to small teams enables them to be responsive to local concerns, but makes it hard to apply consistent priorities across the organization. Organizations often invest a lot of effort trying to find the right balance, when the best model is probably to maintain a dynamic balance: shifting the locus of decision making as different decision attributes come into prominence. Again, this raises questions about who decides who has the authority to make any specific decision.

Of course, changes to power structures and decision making processes associated with product and service innovation will run into all the challenges associated with *managing organizational change*—without a clear impetus, people will question the need for change; without clear communication, different people will interpret objectives and ways of doing things differently; without appropriate training, people will execute new processes poorly; and so on. When something as fundamental as governance is being addressed, these changes will happen in a highly emotive and political environment, exacerbating the challenges.

This is because changes to governance are inherently about changes to power structures. People will be reluctant to relinquish their existing power, resulting in politics and *power struggles*. They may also be reluctant to take on new responsibilities and accountabilities, especially if commensurate resources and rewards are not forthcoming. So they will resist change. On the other hand, such struggles are already going on around product and service innovation in many organizations—the drivers identified above (pace of technological change, changing customer expectations, etc) are already triggering changes that affect the established power structures. An organization is more likely to steer these changes in a beneficial direction if it addresses the governance issues head on.

Yet organizations are often prone to cultural patterns that preclude effective discussion of governance. Low levels of confidence and trust drive many of these patterns. For example, managers may attempt to micromanage and pre-empt the decisions of specialist staff when they lack confidence in the capabilities and motivation of those staff. Those experts may then lose confidence and withdraw from decision-making (e.g. by deferring decisions to their managers), reinforcing their managers' suspicions. Low trust levels can also lead to information hoarding (people hold onto information to protect themselves) and over-analysis (people spend a lot of time seeking "perfect" answers, even in complex situations where high levels of uncertainty and change favour experimental over analytical decision-making styles). All of these behaviours are antithetical to effective governance of product innovation, which requires high degrees of information and expertise sharing, and rapid assimilation of and response to new information.

Some of these challenges are definitional—without a clear definition of governance, people cannot address it effectively. Some of them are due to the difficulty of defining an appropriate governance model in complex, rapidly changing environments. And some of them are due to the inherent difficulty of managing organizational change. (Which, of course, itself involves aspects of governance—who, for example, is empowered to determine the direction of change?)

Definitions

Governance

The Institute on Governance (www.iog.ca) defines governance as follows:

> *Governance determines who has power, who makes decisions, how other players make their voice heard and how account is rendered.*

This emphasizes four aspects of governance:

1. Governance is inherently about power—how it is distributed within the organization, and how it is used to drive behaviours and achieve organizational goals. This encompasses the various types of power that may come into play: the power people hold by virtue of their position in the organization, the resources they control, their expertise, their experience, their charisma, their personal strength, etc.
2. Power is exercised through decisions. Powerful people are able to influence what objectives the organization chooses to focus on, how it chooses to allocate resources in pursuit of these objectives, what structures, processes and systems it chooses to set up, and so on. Good governance ensures that these decisions are legitimate—that the appropriate people are involved in making each decision, and that "due process" is followed in the course of making the decision. It also ensures that decisions are made in an efficient way, and that the organization focuses an appropriate level of attention and resources

on each decision—for example, that important decisions receive more attention and due diligence than trivial decisions.

3. Good governance attends to the concerns of all stakeholders. It ensures that the voice of all stakeholders is heard and that they can influence decisions in an appropriate way.
4. Good governance also ensures that people are held to account for the decisions they make. Although many people interpret "accountability" as being synonymous with "blame" and hence punishment, we interpret it as being closer to "feedback": good governance ensures that the organization tracks the outcomes of decisions and acts to modify them where they are not having the desired effect. (Of course, where individuals consistently make bad or illegitimate decisions this may result in punishment, but that is only one way to improve the outcomes of decision-making, and not always the best.)

We also like one of the Institute on Governance's earlier definitions:

Governance is the process whereby societies or organizations make important decisions, determine whom they involve and how they render account.

This definition emphasises the importance of decision-making. Good governance identifies which decisions are important. It then ensures that the appropriate people are involved in making those decisions, that they follow an appropriate process, and that they are held to account for the results.

Complexity

Product innovation teams must often deal with high degrees of uncertainty and ambiguity. Market data is often incomplete, contradictory and subject to rapid change. Technology capabilities are constantly evolving. The factors that drive market dynamics are, at best, poorly understood. The relationships between these factors are non-linear and cyclic, changeable, subject to unpredictable time lags, and often very non-transparent. These may be characterised as conditions of *complexity*.

Traditional command-and-control management styles do not cope well with complexity; indeed one of their tenets is to reduce complexity and increase predictability whenever possible. However, this has the side effect of reducing innovation, which is inherently about dealing with the novel and the unknown, and hence the complex.

There are two popular models for understanding complexity, the Stacey Matrix (Stacey, 2007) and the Cynefin model by Dave Snowden (Snowden and Boone, 2007). We base our definition on the Cynefin model.

The Cynefin Framework

Cynefin, illustrated in Figure 2.1 and Table 2.1, is a sensemaking framework that helps decision-makers understand their situation, and hence make better choices. Problems can be understood within one of four domains or contexts: *simple*, *complicated*, *complex* and *chaotic*. In addition,

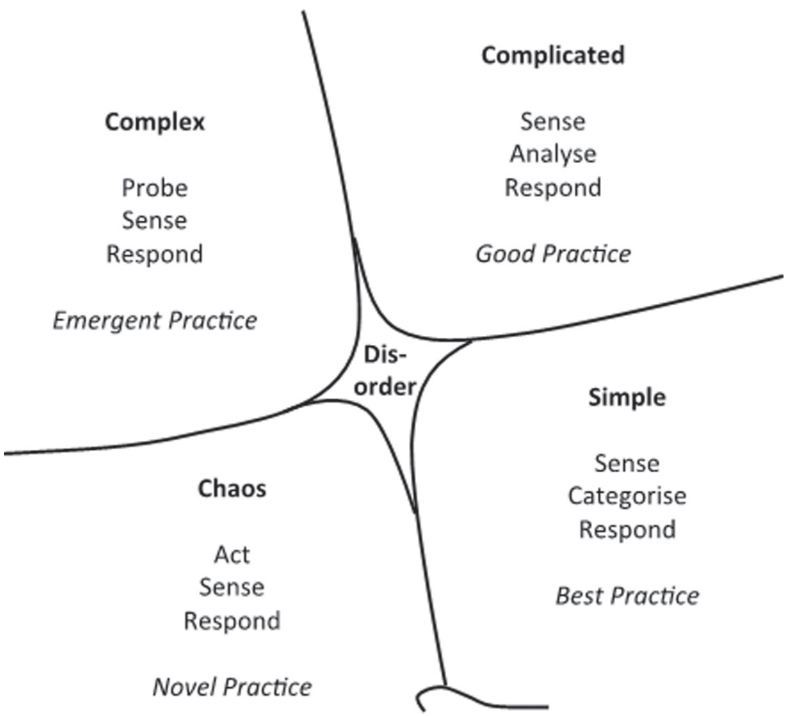

Figure 2.1 The cynefin framework

(adapted from Snowden and Boone, 2007)

Table 2.1 Attributes of cynefin domains

Simple	Complicated	Complex	Chaotic
Ordered		Unordered	
Predictable		Insufficiently predictable	Unpredictable
Known knowns	Known unknowns	Unknown unknowns	Unknowables
Single best solution	Several good solutions	Many potentially useful solutions	Novel solutions
Sense—Categorise—Respond	Sense—Analyse—Respond	Probe—Sense—Respond	Act—Sense—Respond
Best practice	Good practice	Emergent practice	Novel practice
Light switch	Internal combustion engine	Rainforests, democracies	Natural disasters, warfare
Command and control	Experts coordinated by project managers	Servant leadership	Intent of command
Commodities	Exploitation	Exploration	Survival

a fifth context of *disorder* captures those problems that cannot be easily characterised.

The simple and complicated domains are *ordered*. They are predictable, either by anyone (simple domain) or by experts (complicated domain). Causal relationships are visible and can be used to plan actions for the future. Decision making structures can exploit this order and predictability.

The complex and chaotic domains on the other hand are *unordered*. They are unpredictable: causal relationships are not visible enough or stable enough for long-term planning. Decision-making must be set up to allow localised experimentation and action.

In the *simple domain*, causal relationships are straightforward, visible and linear. Problems have one correct solution and “best practice” always exists. Having *sensed* the situation, a simple *categorisation* allows us to determine the best *response*. The action we take is virtually certain to give the expected result; in the odd case when it doesn’t, troubleshooting is easy. Since the results are predictable, decisions can be scripted and processes automated. Governance based on command-and-control models works well.

In the *complicated domain*, people with the appropriate expertise and experience can at least identify causal relationships with sufficient analysis. Problems can be deconstructed into a number of smaller problems that are easier to solve, and the working of the whole system can be deduced from the working and interaction of the components. Problems may have multiple good answers, each with different trade-offs: it makes sense to talk about "good practice" rather than best practice. After *sensing* the situation we need to *analyse* it before we can *respond*. If our analysis is good, the action is highly likely to give the desired result.

Unsurprisingly, this is a domain where experts and specialists thrive. Decisions are made by groups of appropriate experts. Project and mid-level managers play an important role coordinating and supporting the work of these experts.

Unlike the simple and complicated domains, causal relationships in the *complex domain* are cyclical or hidden and can therefore be seen and understood only in hindsight, if at all. The behaviour of a complex system is *emergent*: the system as a whole behaves in ways that cannot be extrapolated from the components.

Without clear causality, it is impossible to find optimal answers. Several more or less likely solutions may exist: the best choice cannot be determined by ex-ante analysis of the situation. It is difficult to predict the impact of any decision: by the time the potential outcomes have been analysed, the chosen option may have expired or the whole question may have become irrelevant.

In the complex context, we must first *probe* the situation, undertaking low commitment, and 'safe-to-fail' experiments. We then *sense* the impact of these probes and *respond* to what we have learned. There are no best practices or even good practices, but rather we allow appropriate practices to emerge from our experimentation. If an action gives good results, we do more of it and try different variations to see if results improve. If an action doesn't work as expected, we try something else. Research organizations typically use this kind of experimental and empirical approach to *emerge* a workable solution over time.

Experimentation is essential in the complex domain, as is acceptance that well-designed experiments are equally likely to fail as to succeed. It is not useful to make detailed plans beyond the immediate future in such circumstances, and centralised chains of command typically struggle to keep up with the ever-changing situation. Distributed decision-making and self-coordination is required for effective operations.

In the *chaotic domain*, all bets are off. The parameters and causal relationships are constantly shifting. While you may be able to exploit a pattern for a while, this is not reliable and can't be repeated indefinitely.

In the complex domain we start by probing the situation, in the chaotic domain our probes yield little useful information. Instead, we must *act* decisively in order to stabilise and simplify the situation. We can then *sense* the situation in the "islands of stability" we have created, and then begin to *respond*. For example,

> The Red Cross is accustomed to working in chaos, but they can only do it repeatedly by simplifying their context. When a disaster occurs somewhere in the world, the Red Cross sends in a trained team and a container with supplies and tools. The container has everything the team needs in order to survive and help victims—water purifiers, canned food, tents, power generators, medicines, communications gear, etc.—until they are lifted out a fortnight later.
>
> The container forms a bubble of order in the surrounding chaos. Because their own working structures, processes and tools are known and ordered, the team can afford to take on complexity and chaos in their operative work. Without this little ordered domain all effort would be spent on surviving, but with the back-up from their ordered domain they can really make a difference.

This is the realm of the emergency and natural disaster. People must be empowered to act rapidly within their immediate situation, guided towards a common goal. Distributed decision-making is essential, supported by clear lines of authority and clearly defined overall objectives and operating principles.

The Borders of Complexity

Most organizations operate in either the complicated or the complex domain, simply because it's difficult to turn a profit in the simple and chaotic domains. Commodities dominate the simple domain: work is performed for a standard (low) fee, or by the lowest bidder. Chaos, on the other hand, is so unpredictable that actions cannot be repeated in a profitable manner, making it difficult to sustain a business.

The borderline between complicated and complex is especially interesting for governance. As we move from complicated to complex, we lose predictability. This manifests itself in the form of frequent and seemingly random operational problems, for which a common root cause is impossible to discern. In such circumstances, a number of patterns of misinterpretation are possible.

If the context has been stable for a long time, people may become *complacent*. When changes occur, they do not correctly identify the context change or its implications. They stick to approaches and methods that worked well previously, but now mysteriously fail to have the desired effect.

Another common pattern is *entrained thinking*, perhaps better known as the "law of the instrument"—if all you have is a hammer, everything looks like a nail. For example, project managers are trained to use project plans, risk lists, Gantt charts and other tools that are appropriate for the complicated domain. When working in the complex domain, these tools must be replaced or significantly adapted.

Oversimplification is also common. Essential details may be abstracted away, giving the impression that a problem is simpler than it actually is. For example, in a well-written piece of software, every detail exists because it's necessary for the program to do its purpose. Any one incorrectly designed or coded detail may cause the program to misbehave or crash, but high-level software architecture diagrams do not accurately convey this significance.

By definition, problems in the complicated domain have good solutions that can be found by experts with the appropriate knowledge. People accustomed to working in this domain may enter a state of *analysis paralysis* in the complex domain, where good solutions are not identifiable in advance. As experts analyse a problem, they continuously unearth details that invalidate their previous assumptions, and the definitive answer seems to be constantly eluding them. Too proud to ask for help, they doggedly continue to analyse the problem until it's too late.

On the other hand, specialists can also become **overconfident** of their own ability to understand issues and identify root causes. Where causality is unclear experts may come to very different diagnoses about the problem and—each having confidence in his/her own analysis—resort to arguing about the nature of the problem and what kind of solution is needed. A more fruitful approach would be to develop a solution through experimentation and observation.

And finally, the trap of *retrospective coherence* is particularly nasty. When causality is unclear it is impossible to plan for every eventuality. In the complex domain, plan-based projects tend to fail due to unforeseen (and indeed *unforeseeable*) circumstances. The events and causal relationships leading to failure can however become visible in hindsight, e.g. in a post-mortem. Believing that the project operated in a predictable environment, the post-mortem may decide that the project plan was inadequate and recommend more detailed planning in future. This adds overheads and diverts attention from managing complexity, increasing the likelihood of future failures and thus feeding a vicious cycle.

These patterns are particularly pertinent as the pace of change accelerates, as rapid change often pushes operations from the complicated to the complex domain. For example, in slowly changing domains, designs are stable and decision-making by centralised committees is viable. In a rapidly changing domain however, the longer you hold on to a design the more likely it is to need rework, and design decisions must be made in frequent small batches nearby or within the teams that will use the design.

Agility

Walk into a factory and you perceive noise, activity and movement. But walk into a software development organization and you perceive silence, inactivity and stillness. A lot of things are happening, a lot of work is being done, but it is invisible to the naked eye. Fred Brooks argues in his famous essay No Silver Bullet (Brooks, 1975) that software is “invisible and unvisualizable”, having no single geometric representation. Software is more complex than any other human construct, and the complexity is arbitrary rather than systematic. Furthermore, software is not only subject to change but also, being easier to change than hardware, acts as an attractor for change.

Because these attributes capture the essence of what software *is*, Brooks concludes that there is nothing that can make software visible, simple and resistant to change. What you can't visualise, model and understand, you can't predict. Thus the software domain is inherently unpredictable, or to put it another way: in software projects the predictability horizon is uncomfortably near.

Nothing has changed in the four decades since Brooks wrote his essay, and the continuing lack of visibility and predictability still makes it very difficult to manage software projects. Despite well-laid plans and the best progress monitoring practices, a large proportion of software projects fail to meet either schedule or budget. And decades of research into project management have had little impact on project failure rates.

Thus a group of new software development methods emerged in the 1990s. Collectively known as "agile software development", or simply "Agile", these methods revolve around the idea that, if we are constantly faced with change and complexity, then we should *design processes to accept change* rather than suppress it. Figure 2.2 shows some of the attributes that enable agile methods to do this.

The general approach of agile methods is to refocus attention on outcomes rather than the processes that produce these outcomes, and on collaboration rather than contracts and specifications. Because software is invisible, complex and malleable, it must be *reified and validated early and often*, and used to *elicit feedback from customers and end users*. The only real measure of progress is working tested software that gives value to the customers and end users.

There are almost as many definitions of agility as there are practitioners, researchers and trainers. We favour the definition synthesised by Kieran Conboy (2009) from the basic principles of agility:

> [Agility is] the continual readiness of an [Information Systems Development] method to rapidly or inherently create change, proactively or reactively embrace change, and learn from change while contributing to perceived customer value (economy, quality, and simplicity), through its collective components and relationships with its environment.

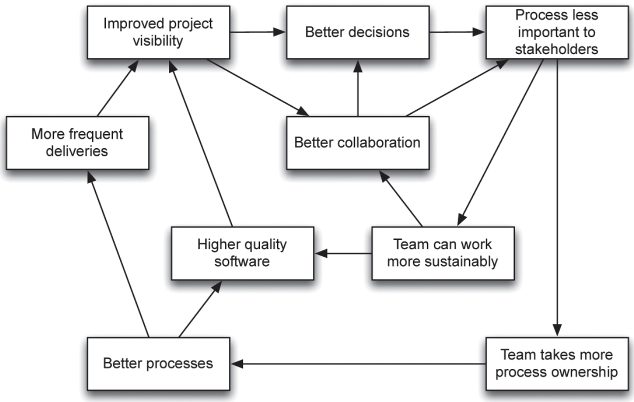

Figure 2.2 Positive feedback loops in agile software development methods

Agile methods are interesting for several reasons. Firstly, the nature of software and software development means that these agile methods embed forms of governance that may be especially relevant to the complex domain in general, and hence to governance of innovation and research.

Secondly, software is an increasingly important element of the innovation chain. A growing number of products and services are based on software, or incorporate software as a key component. Even products that don't incorporate software in themselves are often designed, simulated and analysed using software-based tools. Thus our governance structures must increasingly account for the issues of developing software.

Agility in Practice

Agility is abstract: it is mainly a philosophy or collection of thinking models, combined with values and principles defined in the Agile Manifesto (2001). A variety of methods (almost twenty documented methods exist) supplement these with more specific practices and processes.

Some of these methods, e.g. Test-Driven Development (TDD), Agile Modelling and Pragmatic Programming, consist primarily of sets of mutually supporting agile programming practices. Others, e.g. Scrum, Adaptive Software Development, Feature Driven Development (FDD) and the Crystal process family are more comprehensive, covering software project, product and/or process management for large parts of the product lifecycle. Only a few methods, such as Dynamic Systems Development Method (DSDM) and the Rational Unified Process (RUP), cover the full life cycle including conceptualization and maintenance. More recently, a number of frameworks such as Disciplined Agile Delivery (DAD) and Scaled Agile Framework (SAFe) have tried to bridge devolved, self-organized teams into larger structures.

All agile methods share the following attributes (adapted and extended from Abrahamsson et al, 2002):

1. **Incremental**: small and well-tested software releases are made frequently, using build and test automation.
2. **Cooperative**: customers, developers and stakeholders work together with close communication, enabling distributed authority and responsibility, and rapid feedback.
3. **Straightforward**: the method is easy to learn and modify.
4. **Adaptive**: the method is able to handle (even last-minute) changes to products, processes and the organization.
5. **Self-organising:** the development team and stakeholders own the process, and continuously adapt it to produce more customer value in less time.

Agility in Comparison

Agility contrasts with traditional, plan-driven development methods in several ways.

First, agile methods test the current state of the product empirically and frequently, several times a day, thus increasing *visibility*. Does the code build and integrate? If so, does it pass all tests? If so, which features were tested? These metrics are direct, measuring the *presence of value* (working, useable features) rather than the absence of waste (defects and bugs). Being able to directly measure the outcome gives a reliable and current understanding of the quality level and feature set of our product, making it easier to manage the project. Projects that do not measure outcome directly must resort to secondary, indirect metrics, such as how our initial progress estimates compare to the progress of time.

Indeed, agile methods have a different *understanding of progress*. The product is constantly progressing, as can be evidenced from the outcome, but the concept of "100% done" has little meaning. Progress instead focuses on two questions: (1) "What can we do next to add as much value as possible to the product?" and (2) "How can we improve, so that we can add value even faster?"

Rolling plans, also known as backlogs, support the first question. Agile methods break work down into fine-grained items on demand, then queue these items for implementation according to priority, e.g. based on the perceived value of the work item, the direct cost, the cost-of-delay associated with it, or a combination of these. Because commitment to a work item is only made when implementation commences, items can be radically reordered or replaced when the situation changes.

The answer to the second question can be found in *continuous improvement*, an approach known from Lean manufacturing. As stakeholders become accustomed to seeing value steadily and reliably being added to the product, they become less interested in how the work is done or by whom. Thus the development team can take ownership of the process, to freely modify it and distribute the work as they see fit. The surrounding organization must give them enough latitude to self-organise around retrospection and process experimentation.

Agile methods also strive for *simple products*. This is because software has high holding costs and a low shelf life: many people believe that source code is an asset, but it is in fact a liability. Less code is also less complex, takes less time to write and test, contains fewer defects, is easier to read and understand, easier to maintain and debug, and so on.

Similarly, agile methods attempt to achieve *process simplicity*. Agile processes are uncomplicated, and the mechanics easy enough to understand. Meetings are few, short and frequent; roles are few and people are expected to work outside them if necessary. The process is jointly owned and easy to modify locally.

It can be seen that "agility" brings many differences to "traditional" software development methods: embracing rather than suppressing change; distributed rather than central authority; an emphasis on visibility, transparency and feedback. This shifts the locus of decision making from central managers to self-organizing teams, and requires a very different governance style.

Open Innovation, Crowdsourcing, Co-creation

Many organizations have recognized that they control only a small proportion of the world's expertise in any given area. Customers know more about their own needs than the organization can ever know (although it may be able to help its customers discover and analyse these needs). The pool of specialists in research institutes, suppliers, think tanks, academia, etc. outnumbers the specialists employed directly by the organization. Experts outside the organization's domain of operation may be aware of solutions that could be adapted to solve the organization's problems, if they were aware of those problems. This recognition has led to growing engagement with a number of different techniques.

Chesbrough (2003) identified *open innovation* as "a paradigm that assumes that firms can and should use external ideas as well as internal ideas, and internal and external paths to market, as the firms look to advance their technology", open innovation encompasses a variety of techniques aimed at encouraging people outside the organization's boundaries to engage with its problems and propose solutions. These techniques include conventional joint venturing and contracting with research institutes, publication of challenge prizes, participation in informal innovation networks, crowdsourcing, collaborative product design, and so on.

In the product innovation context, organizations may use *crowdsourcing* to extract ideas and possible solutions from large groups of people ("the crowd"), typically via online forums. In this way companies may gain information about customer needs and preferences by interacting with communities of potential customers, or gain information about solution options and design trends by interacting with communities of innovators, designers and similar thinkers. Crowdsourcing differs from traditional research activities in that it involves more active engagement by the external community—the organization outlines the type of information it is looking for, then community members actively explore the problem and solution space for themselves rather than being closely directed by researchers.

Finally, *co-creation* is a process whereby the organization works jointly with customers to design and develop solutions to customer problems. Compared to the aforementioned techniques, cocreation emphasizes collaborative working—both organization and its customers are active partners in the process, working together through activities such as workshops and online collaborative spaces in order to analyze customer needs and problems, and hence develop potential solutions.

It can be seen that all of these concepts increase the permeability of the organization's boundaries—information and ideas must flow between the organization and the outside world if it is to engage in them. This creates questions about the flow of control and decision-making—the organization must share some of its decision-making power with the external parties that participate in its innovation process. How should decision rights and processes, ownership of intellectual property, etc. be reconfigured to best support this, while still protecting the organization's assets?

Why Governance Matters

Organizational Effectiveness

Organizations make many decisions during the course of product innovation—which markets to be in, which customers to address, which products to develop, how to design and manufacture those products, how to price and market them, etc. They must prioritize their use of limited resources, constantly choosing where to focus their budget, skills, time, specialist facilities, etc. The effectiveness and efficiency with which they make such decisions does much to determine whether they succeed. Thus effective governance contributes directly to product innovation success.

In particular, effective governance ensures four things:

1. *People understand which decisions matter, and how they contribute to organizational goals.* Innovation teams make hundreds of decisions every day. Many of these decisions are trivial; only a small percentage has a large impact on organizational goals. An effective governance framework will identify those important decisions and ensure that attention is focused on them. Furthermore, it will make it clear just

why and how these decisions contribute to overall goals, so people are aware of the bigger picture as they make decisions.

2. *The right people are involved with each decision*. To make a good decision, we may need to consult with a wide range of expertise. We may need to engage with diverse stakeholders to ensure we understand their needs and perspectives. We may need to build buy-in from staff members who will execute the decision, negotiate with resource owners, obtain consent from regulators, etc. An effective governance framework will identify who needs to be involved in each type of decision, and what power they have to influence that decision. Do they have a vote, or even a veto? Or are they simply consulted in order to gather relevant information or opinions? It will also identify who is accountable for the decision, i.e. who has the ultimate authority to approve the decision, must justify the resources expended as a result of the decision, and bears responsibility for the consequences of the decision.
3. *An appropriate process is used to make each decision*. Following the agreed process gives legitimacy to a decision. When people can see that "due process" has been followed, they're more likely to buy in to the outcome and hence to execute the decision effectively. Moreover, by defining the process upfront, we increase the efficiency and effectiveness of decision-making. People don't need to spend time "deciding how to decide" for each decision, but rather can get on with the process of gathering information, conducting research, undertaking experiments and trials, identifying options, assessing those options against agreed decision criteria, etc. They are less likely to miss important steps or overlook key considerations. The organization can also provide training (e.g. by running simulations), ensuring people execute the process well when under pressure. Thus an effective governance framework will outline the process for each major decision, in sufficient depth to support people to make the decision, yet without overly constraining their actions and professional judgement.
4. *Appropriate mechanisms for feedback and accountability are in place*. Effective governance ensures that the organization monitors the outcomes of decisions and, if necessary, adjusts those decisions to reflect new information and learning. This is especially important

in dynamic and uncertain environments (almost always the case for product innovation), where decisions must be made on the basis of incomplete and rapidly changing information. Effective decision-making is then about making tentative commitments and constant adjustments, rather than conducting "perfect" analysis and getting everything right at the outset. An effective governance framework will also define mechanisms to account for the resources expended as the result of each decision. Finally, it will ensure that these feedback and accountability mechanisms extend to the decision-making process itself—a well-governed organization constantly looks for opportunities to improve the way it makes decisions.

In summary, effective governance supports organizations to make good decisions—ones which are grounded in evidence and awareness of the current situation, which are backed by adequate analysis, and which are accepted by major stakeholders. It enables them to make those decisions in an efficient way, and it ensures that they track outcomes and hence constantly steer towards their desired goals. In the fuzzy and dynamic world of product innovation, this capability to constantly make and adjust decisions is critical to success.

Effective governance also tends to favour open and transparent decision-making. To govern well, organizations must establish effective mechanisms for monitoring and recording their decisions—who was involved, what process and criteria they used, what decision they made, and what outcomes that decision led to. Such transparency makes it easier for managers to understand what is going on within the organization, and hence to steer it effectively towards organizational objectives. It can also reduce costs associated with regulatory reporting and compliance.

Conversely, when governance is ill-defined, organizations may suffer from a number of issues. Often, *decisions are delayed*, either because people must spend time defining bespoke decision-making processes for each decision, or because they must spend time identifying and managing stakeholders (e.g. scheduling meetings to discuss options). At worst, people may use the lack of clarity to *avoid making decisions* altogether.

At they other extreme, *decisions may be rushed*. Delays in one part of the decision-making process often lead to shortcuts elsewhere. Organizations may scrimp on data gathering and analysis, for example, to compensate for time taken to manage stakeholders. A common pattern is to spend a long time defining "objective" decision-making processes, only to run out of time and make hasty decisions based on intuition and gut feel.

In so doing, organizations *waste a lot of effort*, spending an enormous amount of work on defining bespoke decision-making processes for every decision, fighting about decision rights, arguing over the minutiae of trivial decisions, constantly consulting people on decisions for which they have neither expertise nor interest, etc. Again, this diverts resources from activities that may contribute more to effective outcomes, such as gathering data or conducting experiments.

After all this, people may challenge the legitimacy of decisions, either because the right people weren't consulted or because the appropriate process wasn't followed. This act of *revisiting decisions* leads to yet more delay and wasted effort.

Lack of clear governance can also lead to *inconsistent decisions*. Different parts of the organization may use different criteria and information, and hence come to different outcomes for the same decision. Such inconsistency can be appropriate in highly uncertain environments where the organization wants to test different approaches, but it also increases coordination overheads and destroys economies of scale. At worst, it can cause confusion amongst customers, regulators and other stakeholders.

Finally, demarcation disputes and infighting about accountabilities all too often result in *relationship breakdowns*. The resulting lowering of trust levels can lead to a negative spiral—people interpret actions by their "opponents" negatively and hence respond aggressively, further damaging the relationship. In such an environment, effective decision-making becomes almost impossible.

Organizations may try to compensate for delays, waste and inconsistency by defining rules and policies to cover every situation—in other words, by introducing *bureaucracy*. This rarely works well in a product innovation environment, which is focused on dealing with novel situations. Attempts to apply inappropriate rules, or to customise existing rules for new circumstances, may simply lead to further delay and waste. Conversely, in the absence of clear lines of authority and decision-making processes, people may simply go their own way. This leads to *anarchy*.

As mentioned above, anarchy may be appropriate when the organization wants to try numerous approaches in order to determine what works best in highly uncertain or complex environments. However, it creates high coordination costs and high degrees of inconsistency. Alternatively, powerful people may use lack of clarity to seize control. *Despotism* can sometimes lead to extremely efficient and effective governance, but only in the interests of the despot—wider organizational goals and the interests of other stakeholders may be ignored.

Ultimately, all of the above issues lead to *poor decisions* and hence poor outcomes. Decisions are made by default, or without adequate analysis and consideration. The perspectives of key stakeholders and technical experts are ignored. Resources are squandered on trivial decisions or on organizational infighting. No one monitors the results of decisions, so there is no way to steer and adjust when poor decisions are made, or when new information is acquired.

Organizations that don't consciously and actively tend their governance end up spending a lot of time on it. They address it afresh for each decision as they argue about due process and decision rights and accountabilities. They then end up with little time for the decision itself. So they make bad decisions. In rapidly moving markets, product innovation teams can ill-afford the waste and delay this creates. Worse, by paying little attention to governance, organizations often find that their governance decays into inappropriate forms. In the absence of well-defined and consciously tended governance, the ground is fertile for extreme forms—anarchy, despotism or bureaucracy—to take hold. Such patterns are antithetical to effective product innovation, with its need for high levels of communication and information sharing, and its emphasis on rapid response to new information as it arrives.

Societal Benefits

As well as benefiting the organization, good governance gives benefits to the society within which that organization operates. By ensuring clear and equitable distribution of power within the organization, its staff and partners, and other stakeholders, an effective governance framework can, for example, help an organization embed the values set out by the United

Nations Global Compact (http://www.unglobalcompact.org/). This addresses concerns such as:

- **Human Rights**. An effective governance framework will ensure that innovation teams consider the concerns of all people affected by a product's manufacture, usage and disposal as they make decisions about the product and its lifecycle. This can help ensure that the product does not damage human rights. Thus, for example, ways in which a product might be used to violate people's right to privacy could be identified at an early stage and eliminated or mitigated through appropriate design choices.
- **Labour Rights**. Likewise, good governance ensures that the concerns of staff throughout the supply chain are addressed when making decisions about product design, manufacture, support and disposal. Many organizations have used this approach to reinforce labour rights within their global supply chain, e.g. by ensuring that suppliers do not use forced or child labour during product manufacturing.
- **The Environment**. Likewise, good governance ensures that innovation teams consider the environmental concerns of all stakeholders. This increases the likelihood that products will be manufactured, used and disposed of in an environmentally sustainable way. The growing trend to account for lifecycle environmental performance as well as financial performance reinforces this attention to environmental sustainability.
- **Anti-corruption**: Feedback and accountability go hand-in-hand with transparency and openness. Well-governed organizations tend to be more transparent, and thus better placed to work against corruption. For example, when innovation teams procure components and services openly, with clearly identified decision-makers and well-defined decision criteria, then scope for bribery is much reduced.

It can be seen that a well-governed product innovation process can contribute to societal good in many ways. This is particularly true when an organization works with its partners to embed good governance across the product's supply chain and throughout its complete lifecycle. The growing tendency to employ open innovation and a global supply chain gives innovation teams substantial scope to embed the values of the UN Global Compact across society.

An organization that is seen to respect the rights of its internal and external stakeholders, and to pay due attention to environmental sustainability and other societal concerns, is likely to gain significant indirect benefits. For example, customers are increasingly well informed and have started favouring organizations that produce their products in a fair and sustainable way. This *improved customer perception* can lead to increased market share, improved customer loyalty and retention, greater brand equity, etc.

In addition to customers, staff members are likely to favour organizations that treat them well and contribute positively to society. *Improved staff perception* can lead to greater ease of recruitment, higher staff retention, and greater willingness for staff to commit to organizational objectives. Similarly, *improved partner perception* means that innovation partners are more likely to engage with organizations that are seen to respect the rights of all stakeholders in the supply chain.

Further, governments, trade organizations and other regulating bodies may be more likely to consider the views of organizations that are seen to contribute positively to society, thus gaining *greater influence with regulators*.

Organizations also have less need to act defensively when operating in an environment where legal and human rights are respected. Thus they do not need to invest so much in protecting staff and property, creating legal protections, buying insurance etc., resulting in *reduced operating costs*. Likewise, some classes of investor favour organizations that are seen to act positively within society, and give them *easier access to capital*.

Good governance is not an overhead—it can create a virtuous circle, generating wins for all stakeholders. However, the way those stakeholders perceive governance, and what they consider to be "good governance", may vary substantially. In order to establish effective governance, an organization must deal with these perceptions.

Perceptions of Governance

Governance suffers from the same problem as strategies, values and processes: the actual *lived governance structures* may diverge from the *documented structures*, which in turn may be different from the *desired structures*. Furthermore, there may be more than one 'lived governance' structure. Since organizations are made up of people with different tasks, roles, backgrounds, experiences and personalities, their perceptions of the current governance structures can in fact be vastly different.

These different perceptions can themselves undermine good governance. When people work at cross-purposes, invested effort goes to waste and more effort is needed to consolidate and rebuild the pieces. Differing visions also make ripe ground for internal dissent and political power struggles. In an organization with a clear and well-understood governance structure, people are more likely to work effectively and efficiently together.

Consider the following case study[2]:

> A department in a multinational enterprise was given free reins and an unrestricted budget to modernise the enterprise's product portfolio. Within months, three competing visions emerged:
>
> 1) Some people wanted to invest in a new platform that would allow the company to produce new products faster.
> 2) Others wanted to push several successive products out quickly and let the platform emerge and stabilise over time.
> 3) Others believed that the company should form a standards consortium with partners and collaborators and thereby take a leading role in the industry.
>
> Everyone had their opinion, but on the whole, most people were concerned with getting stuff done, whatever that "stuff" happened to be.
>
> The Director of the department was a charismatic and extrovert engineer, now promoted into a position that required a politician

[2]Again, this case study is drawn from our experience working with product innovation organizations.

> with the ability to juggle different perspectives. He developed a tendency to leave difficult decisions open until they resolved themselves. In this case, he left a decision vacuum: no-one had clear responsibility for resolving the issue, and few people were even aware of its importance. This vacuum allowed managers and engineers to set their own priorities. The situation involved very little malevolence or aggression: it was simply that no one knew who should make the decision between three equally good options.
>
> This left the engineers building a changing product on a changing platform based on changing standards, further befuddled and delayed by constantly changing priorities. Unsurprisingly the first product was released on a half-baked platform more than a year behind schedule. The budding standards group was silently abandoned by the other partners and fizzled out. The department was closed down two years later.

This section explores some common patterns in perceptions of governance, and the way they undermine effective decision making in product innovation organizations.

Background

We became interested in the question of governance perceptions during a workshop on complexity in 2012. We thought it would be interesting to ask different people to draw their perceptions of governance by first listing a number of decisions important to their context, then forming a Cynefin diagram from those decisions.

The first trials surprised and delighted us. For example, a group of project managers stated that deciding on the project schedule was a complicated problem, bordering on complex. A group of engineers on the other hand saw the same decision as simple. When the two groups noticed the difference, an interesting and constructive discussion ensued.

The project managers explained that determining the schedule involved negotiating, consulting, delegating, informing and generally interacting with several stakeholders on different levels of detail over several weeks or months. The engineers on the other hand were only informed after negotiations had been concluded and thus did not perceive how much effort had gone into producing an answer. After this discussion both groups were a bit wiser: the engineers showed a greater appreciation for the work of the project managers, and the project managers said they would consult and inform the engineers when planning the next project.

On the basis of our experiences with these trials, we developed a workshop format that let groups plot the perceived complexity of different decisions on the Cynefin diagram, while simultaneously placing the same decisions on a decision/role matrix. In order to produce comparable results, we provided ready-made lists of roles and decisions that are valid across many organizations. The workshop is run in several groups within each organization, and its value lies in the differences between the resulting complexity and role matrices.

To date we have collected data from approximately 20 teams in a handful of organizations, typically R&D units consisting of 100–500 employees within larger enterprises in the telecom business (both operators and equipment manufacturers). In the workshops, mid-level managers typically form one group, quality managers another, system architects a third, developers a fourth, and so on. For the purpose of raising awareness and collecting feedback, we have also run the workshop in special interest groups such as the British Computer Society and Agile Finland and at several conferences on software agility.

While we certainly need to gather more data, patterns have already emerged that we can identify and recount here. The information presented below is based on preliminary results from ongoing research. It reflects our current understanding of how perceptions of governance might differ within an organization, and should be viewed as anecdotal.

Patterns of Perception

The workshops contain two different activities, the first activity reflecting the perception of the *complexity of a decision*. Preliminary analysis has revealed a number of interesting potential patterns. First, being involved in making decisions helps people appreciate the complexity of those decisions.

People who are involved in making a decision often categorise it as complicated or complex, while those who are merely informed of the results often perceive the same decision as simple. These differences can create conflicting expectations between managers at different levels in an organization.

Second, different work domains tend to have different complexity levels. For example, people and teams who work with technical issues tend to see their jobs as primarily complicated, i.e. quite predictable although requiring expert knowledge. Project planning decisions (e.g. scheduling, scoping, resourcing) are seen as either complex or complicated by the groups performing them. Project and product managers tend to see their own jobs as complex (or even chaotic). And in most organizations we surveyed, managers thought that getting people to collaborate and share information was clearly chaotic—fraught with uncertainties and unexpected errors and miscommunications.

The second activity of the workshop explores the perception of *who owns a decision*. Again, we found some interesting potential patterns in how power is distributed horizontally and vertically.

Among peers or groups of people with approximately the same power in the organization, we found evidence of *decision vacuums*. These occur when everyone thinks that someone else owns the decision, meaning that no one takes responsibility for it. We speculate that this may happen for many reasons—miscommunication, ignorance that the decision exists, a desire to avoid accountability, etc.—but the effect is the same: decisions don't get made, or they get made by default. For example, when decisions about the prioritization of work fall into a vacuum, teams easily default to polishing their latest work while waiting for "someone else" to decide what they should do next. Decision vacuums can be a significant source of delay, inconsistency and standoffs.

The opposite of vacuums could be called *decision stand-offs*. Multiple parties each think they should own a decision, while being aware that others also claim some ownership. This may be resolved through negotiation or by reference to corporate hierarchies and other power structures, or it may lead to protracted argument and political infighting. For example, in one organization project managers thought they were responsible for deciding when a work item is completed to adequate quality levels. Developers also claimed responsibility for this decision. It emerged that projects spent a lot of time debating the "doneness" of work items and arguing about what constituted adequate quality, separately for each item.

In between vacuums and stand-offs, we find the concept of *outliers*: multiple parties believe that they alone own a decision, but do not recognise the involvement of others. For example, a company that used open source components in their product recruited several developers from open source projects. These developers were well-educated, often brilliant, and very happy to work on their pet projects, but owed more allegiance to their open source community than their employer. They therefore tended to prioritize development of functions benefiting the community over those supporting the company's product. Priorities and schedules set by the company's managers did not influence their decisions much, and constant reminders changed their behaviour only temporarily.

We also found evidence of *layering*. For example, project and product managers often attribute more decision power to themselves than others attribute to them. This is a potential source of conflict and stand-offs. Similarly, mid-level managers often attribute more decision power to operational teams than the organization does on average. This creates conditions for a vacuum—the manager thinks a team is empowered to make a decision, but the team doesn't realize it has that power.

Teams seem to fall into one of two types. The first type is independent, making their own decisions; the second type is dependent, taking orders from project managers, product managers, specialists, etc. No teams were found to inhabit the middle ground, suggesting that the scale is bipolar rather than gradual. Each type of team, of course, needs (or is nurtured by?) a very different management style.

In this section, our analysis has focused on patterns of dysfunction (while the next section looks at models of "ideal" governance). One function of effective governance is to recognise when such dysfunctions are in play, and take action to resolve them. This is part of the fourth (feedback and accountability) aspect of governance, identified in the definitions above.

Models and Trade-offs

Organizations are more likely to establish effective governance when they tune the allocation of decision rights to the characteristics of decisions. Decisions about market requirements, for example, may require a different decision-making structure to decisions about technical solutions or product pricing. Many organizations limit their options here, for example making all product decisions in a single decision-making body. This section explores a number of models for allocating decision rights, and discusses the trade-offs that must be considered when choosing amongst these models.

Weill and Ross (2004) define six "archetypes" for allocation of decision rights. These archetypes, slightly modified for our context of product innovation, illustrate the range of ways in which decision rights can be allocated. They are as follows:

1. **Business Monarchy**: A central group of business executives (or a single executive) makes the decision. For example, a central committee might make decisions about which markets to address and how to allocate investment across the product portfolio. In the extreme case, the executive committee makes detailed decisions about all aspects of each product—design, "look-and-feel", and so on.
2. **Technical Monarchy**: A central group of technical specialists makes the decision. For example, a group of technical architects might decide which technologies product teams will use, and how they will deploy these technologies. In extreme implementations, these technical specialists might decide on all aspects of the product portfolio. (This is common in technology-driven startups.)
3. **Federal**: Representatives from several organizational units come together to make the decision, typically via consensus or some voting mechanism (illustrating that allocation of decision rights is often interlinked with the decision-making process). For example, technical specialists from a number of product teams may come together to make decisions about common product line architecture. Federal models ensure that many units have a say in the decision, and hence can help build buy-in across the organization; they can also be cumbersome and prone to delay and blocking when there are substantial differences between units.
4. **Duopoly**: A central group of specialists works with representatives from the organizational unit affected by the decision to make the decision. For example, experts from a central technology unit might work with business managers from a product team to make decisions about product design and implementation. Or the product managers

for an individual product line might work with central executives to decide on priorities for investment within that product line.

5. **Feudal**: Each organizational unit makes its own decision. Units may be organised by product line, functional specialism, geography or some other dimension or combination of dimensions. Likewise, they may range in size from major organizational units down to individual product teams (in which case the model grades into Anarchy). The essence of this archetype is that each unit makes its own decision without wider organizational input. Thus, for example, a geographic unit might decide which products to bring to market in its region.
6. **Anarchy**: Individuals or small units make the decision, based solely on their local needs and decision criteria. Anarchies can be useful when an organization wishes to operate several independent "experiments" to explore a new or rapidly changing domain, or when each team operates in a very different environment. Thus, for example, the organization may set up several "skunk works" teams to explore options for entering a new market, or it may allow teams developing products for very different markets to operate with a high degree of autonomy.

The archetypes may be combined. For example, many organizations set overall policy and define guidelines using a monarchic or federal model, then use a feudal or anarchic model to make individual decisions. Depending on how rigorously they enforce the central policy, this then gives each organizational unit more or less latitude, while still maintaining a degree of consistency across the entire organization.

No single archetype or combination of archetypes will be optimal for every type of product innovation decision. An effective governance framework might therefore choose the archetype or combination that works best for each decision type. This choice is rarely straightforward, and organizations must typically make trade-offs between a number of diverse factors.

First, each model varies in its ability to assimilate new information, affecting the *speed of decision-making*. In general, centralised models (monarchies, federations) have longer chains of command from operational teams to central decision makers and hence can be slow to make operational decisions. Monarchies (and especially despotisms) can however make rapid strategic decisions, as the decision-makers act with considerable authority. Devolved models (anarchy, feudalism) have shorter chains of command and hence can make faster operational decisions. Anarchies can be especially quick to react, if somewhat chaotic. Federations, with their requirement to consult widely and build agreement across multiple organizational units, tend to make decisions slowly.

Related to speed is *frequency of decision-making*. Some decisions need to be made regularly; some are rare; some are less predictable than others. It makes sense to automate the regular decisions where possible, e.g. by defining clear policies and setting up systems and tools to support them. In such cases, centralised models (e.g. monarchies) work well—the cost of developing policies and tools can be spread across many decisions. On the other hand, automating rare or one-off decisions is rarely cost effective. For such decisions, it makes more sense to convene the affected stakeholders as necessary and hence decide jointly. Thus federal and duopoly models may be more applicable.

Unsurprisingly, the *complexity of the business domain* is another important factor. Complex domains are not very predictable, and even a small detail can, if misunderstood, cause inordinate amounts of rework and delay. Keeping on top of complexity requires both high speed and a high frequency of decision-making, which may be provided by devolved models such as feudalism and anarchy. If the domain is merely complicated, devolved models do not necessarily provide enough cohesion, in which case federations or monarchies can work better.

Centralizing decision-making in monarchies and federations helps ensure *organizational consistency*—that consistent approaches and criteria are applied to all decisions. Appropriately configured duopolies can also perform well here. Thus these models perform well where consistency is valuable, e.g. to build consistent look-and-feel across several product lines, or to develop a product line architecture that allows components to be reused across multiple products, or to exploit economies of scale by purchasing in large batches. Feudal and anarchic models struggle to deliver the same consistency.

Compliance with regulatory requirements, mandatory or voluntary standards (e.g. ISO standards for quality, security, environmental performance, etc.), and other similar instruments tend to be easier when the organization can demonstrate consistent processes and decision-making. Thus models that favour consistency also work well here.

In order to make good decisions, it is important to have an understanding of all factors that influence the decision, also known as *situational awareness*. For operational decisions, this favours people who are "on the ground"—people close to the customer tend to be most aware of customer needs and other market factors, while people who are actively working with a technology tend to be most aware of its capabilities and limitations. Thus devolved models work well. For strategic decisions, awareness of wider organizational goals and strategic context may be more important, in which case models such as monarchy and duopoly may be more relevant (although even here, awareness of what is going on "on the ground" can be important).

Likewise, people may need *access to expertise*—the relevant technical, financial, legal, commercial or other specialists—in order to make a good decision. The chosen governance model must ensure that the relevant expertise is available to the decision makers. This often favours duopolies.

Good decisions are useless if they cannot be executed. Obtaining *buy-in to decisions* from the people who will execute them is therefore essential. People tend to buy in when they feel that they can influence the decision-making process, so devolved models (anarchy and feudalism) perform well here. Federal models can also score well—going through the process of building agreement across multiple units can be slow and painful, but when it is done, people are more likely to buy in to the resulting decision.

Many companies seek to optimise *utilisation of specialist skills and resources*. It can be easier to manage such skills and resources (e.g. legal experts, technical experts, specialist laboratory equipment) if they are placed into a central resource pool. For example, this allows people to prioritise work in a way that optimises use of scarce skills. In such cases, a centralised decision-making model (duopoly or technical monarchy) may work best. However, this can cause specialists to become separated from product innovation teams, thus losing situational awareness and creating queuing delays.

Finally, *culture* also plays an important role. Organizations are generally more comfortable with some archetypes than others. For example, a company founded and operated by a small number of people may be a business monarchy; technocratic organizations may be most comfortable with technical monarchies; a research university may favour feudal or anarchic models. As people generally work more effectively within comfortable forms, it can make sense to default to the culturally preferred form when there is no strong reason to use another. The problem, of course, is that many organizations use the culturally preferred form even when there are strong reasons to favour alternatives.

Table 2.2 summarizes these trade-offs. It can be seen that no archetype provides the best performance against every trade-off.

Many of these trade-offs entail balancing the benefits of centralised and devolved decision-making. Centralizing decisions helps ensure that policies and objectives are applied consistently throughout the organization. It also makes it easier to manage scarce skills and resources efficiently. However, it risks keeping decision makers remote from local operational concerns and customer needs. It also lengthens chains of command, slowing down decision-making and reducing people's buy-in to decisions. Devolution gives the reverse: in particular, it can be a way to build buy-in, speed and situational awareness—all vital in product innovation.

Many organizations address this problem by separating policy from implementation—one group of people sets policy for a decision type (e.g. what standards to apply, what decision criteria to use), while another group then applies these policies in order to make individual decisions. This yields the four broad options listed in Table 2.3.

Of course, an organization is free to use different models for different decision types. It may, for example, use an anarchic model in the early stages of product development, when the focus is on rapidly exploring many options in order to buy information about different markets. It may then centralise decision-making as it integrates the lessons learned through such market experimentation into its global product lines.

An organization might also use a dynamic mix of these models. Some organizations shift between centralized and devolved models as a conscious strategy to build internal skills and expertise. People might work initially in a central pool in order to build expertise and consistency. This pool is then dispersed to field locations in order to apply that expertise to specific products while building local knowledge. The central pool is

Table 2.2 Trade-offs in Governance Models

	Business Monarchy	Technical Monarchy	Federal	Duopoly	Feudal	Anarchy
Speed of Decision- Making	Can be fast for strategic decisions. Long chains of command may delay operational decisions.		Generally slow, due to need to build consensus.	Often a compromise between central and devolved models. Can work well when it brings together just the right mix of skills, authority and situational awareness.	Can be fast, if chains of command are short.	Can be fast, if chaos does not prevail.
Frequency of Decision-Making	Centralized models can exploit economies of scale, e.g. building policies and tools to automate decisions.		Can be a strong way to develop policy. Tends to impose overheads.		Tends to create inconsistencies and inefficiencies across the organization.	
Consistency & Compliance	Can be a good way to ensure consistency and compliance across the organization.				Tends to create inconsistencies and inefficiencies across the organization.	
Situational Awareness	Central decision-makers can become divorced from operational realities, customer concerns, etc.		Can consider a wide range of viewpoints, so maintaining awareness. This is lost if internal politicking prevails.		Can be close to operational reality. Risks focusing on unit-level objectives.	Can be close to operational reality. Risks losing wider organizational context.
Access to Expertise	Can be a good way to make access to scarce expertise widely available.		Can be a way to bring together expertise from across the organization.		May struggle to build deep pools of expertise.	
Buy-in to Decisions	Buy-in may be weak if decision makers become divorced from operating units.		Can be a strong way to build buy-in across disparate units.		People in small teams and units with strong sense of identity can buy-on strongly to local decisions.	
Efficient Use of Specialists	Can be a good way to ensure efficient utilisation of specialist skills and facilities.		Rarely the model to choose if efficiency is a concern.		May struggle to use scarce resources efficiently.	
Culture	May favour any form, depending on organizational history, context, etc.				May favour any form, depending on organizational history, context, etc.	

Table 2.3 Centralized versus devolved governance

Define policy centrally **Implement it centrally**	**Define policy centrally** **Implement it locally**
Maximizes consistency and compliance, and allows the organization to build an efficient central pool of experts to support decision-making. The organization must build adequate communication mechanisms to ensure speed, situational awareness and buy-in.	Allows local teams to act quickly and with awareness of the local situation. Centrally defined policy ensures consistency across the organization. There is a risk that different teams will interpret policy differently, or even ignore or subvert it due to lack of buy-in to the central unit's policy.
Define policy locally **Implement it centrally**	**Define policy locally** **Implement it locally**
Allows organizations to pool specialist expertise into a location where it can be managed efficiently, while still allowing individual teams and units to decide how to use that expertise for their circumstances. Many outsourcing models work this way—a single service provider performs work in accordance with requirements and policies set by multiple purchasers.	Feudal and anarchic models allow teams to react quickly to local circumstances, and to rapidly extend and redefine policy as new circumstances arise. They do this at the expense of overall organizational consistency and efficiency. (Many organizations are reluctant to experiment with "anarchy", but it can be highly effective in some situations, e.g. when an organization needs to explore many options in a chaotic environment.)

then reformed in order to bring local knowledge back to the center. And so the cycle continues.

Finally, modern communications tools can reduce the impact of many of these trade-offs. Tools such as video conferencing, mobile phones, instant messaging, team collaboration environments, and suchlike, all serve to increase the facility with which people can communicate organizational objectives, local situational awareness, expert opinions and feedback, etc. This can enable centralised decision-making bodies to gain situational awareness and to communicate their decisions more effectively. Thus these tools can mitigate the weaknesses of centralized decision-making models.

Equally, such tools enable organizations to communicate overall objectives and strategic intent to devolved teams. Or they enable fragmented teams to coordinate their actions and hence operate with greater consistency. Thus they also mitigate the weaknesses of devolved decision-making models.

Nonetheless, it remains the case that many innovation projects fail through weaknesses in communication. Effective communication is inherently difficult, especially in uncertain, fast-moving environments. Technology can reduce the problem, but it cannot eliminate it. Thus it remains important to align governance structures with the key decisions that the organization must make.

Heuristics

So, governance is complex. We must trade-off many factors and options. We must adjust it dynamically to changing circumstances. Where does that leave us? This section, based on our experience working with organizations across the public, private and not-for-profit sectors, outlines nine heuristics for establishing and sustaining good behavior in the organization, making it easier to install appropriate governance structures for product innovation.

1. **Address Power and Politics**. Governance is about power structures, within the organization and between the organization and its partners and other stakeholders. Power comes from many sources—position in the organizational hierarchy, control of resources, personal expertise and charisma, support from other stakeholders, legal authority. A decision cannot be implemented if it is not backed up with the right mix of power—good governance ensures that mix of power is brought to bear.

   Many governance initiatives fail because they focus on the minutiae of decision-making rather than on mobilizing necessary and legitimate power. This confuses governance with management. Governance is about ensuring that the right decision makers are engaged. Management is then about making the necessary decisions—gathering information, identifying options, making choices, etc. When governance encroaches on management, it tends to become bureaucracy. It tries to predict all eventualities and prescribe ways to deal with them. This is unlikely to succeed in product innovation, where high levels of uncertainty and the need to respond rapidly to new information are the norm.

2. **Enable People to Exercise Judgement**. Good judgement adds more value than rule-following. Governance bodies may be able to define prescriptive policies for simple decisions, but they can rarely do this for many of the decisions that occur in complex, uncertain environments. In product innovation, it is more important to ensure that the right people are engaged, and that they have access to the appropriate tools and information sources. This then frees them up to exercise their professional judgment when making decisions.
3. **Favor devolved control**. People who are close to the situation—through talking to customers, working directly with new technologies, etc.—tend to understand local capabilities and customer needs far better than central policy makers. Thus it makes sense to devolve control to individual product teams wherever possible. Organizations need to place some bounds around these teams, e.g. setting overall budgets and market objectives, to keep them aligned with organizational priorities. But innovation teams will generally deliver more value when central controls are relatively lightweight.
4. **Articulate Organizational Objectives**. People need to understand the wider context if they are to make decisions that correctly balance local circumstances with organizational goals. When most decision-making is devolved to local teams, the organization must communicate its objectives clearly so that teams can make decisions that align to these objectives. This also helps build consistency across the activities of different teams.
5. **Create Transparency**. Good decision-making requires high levels of awareness; it is paramount that relevant, fresh and trustworthy information is available when and where it is needed. Transparency also makes it easy for others to see what is happening, improving communication and accountability, and preventing misuse, corruption and undue politicking.
6. **Keep Policy Clear and Simple**. Organizations generally need to define some amount of central policy, e.g. to ensure consistency across teams, to support regulatory compliance. However, defining too much policy can be counterproductive. Complicated bodies of policy take too long to understand and create too much scope for conflicting rules. And they frequently fail to anticipate important

issues that arise during the course of product innovation, rendering them of little value to innovation teams. Innovation gains most from simple policies that set clear boundaries and define overall principles. People can then interpret the nuances that apply to their specific situation.

7. **Regular Cadence; Small Batches**. When decision-making bodies meet infrequently, they create delays. For example, product teams spend a lot of time with progress blocked while waiting for decisions. And because decisions are infrequent, teams spend a lot of time crafting their inputs to meetings rather than developing the product. Even scheduling meetings into people's diaries becomes a major task.

   Large, infrequent meetings also tend to be ineffective. Because they must address a large batch of decisions, people pay little attention to each individual decision. Attention begins to wander before the meeting is finished. And because the gap between the meeting where a decision is made and the meeting where its outcomes are assessed is long, people struggle to learn from experience.

   Decision-making bodies tend to be more effective when they meet frequently (precluding the queuing delays and long feedback loops) and at regular times (precluding the scheduling issues).

8. **Seek Feedback and Learn From It**. Even with "perfect" governance mechanisms in place, people will make mistakes. In the face of uncertain and incomplete information, they'll make incorrect assumptions. They'll overlook key information. They'll be blindsided by competitors. And governance mechanisms are rarely perfect—new groups of stakeholders emerge and influence decisions without being included in formal governance structures; changed technology capabilities require adjustments to processes; policies fail to reflect changed circumstances; and so on.

   An effective governance framework therefore needs to capture feedback at two levels. First, it needs to create mechanisms to monitor the outcomes of decisions and adjust the decisions when they are not having the intended effect. Second, it needs to monitor the effectiveness of the decision-making process, and adjust governance structures where they are not operating effectively.

9. **Be Careful of Institutions**. While socially acceptable forms (institutions) of organization and governance—e.g. the matrix organization, project management, yearly budgets etc.—may be useful, it should be remembered that they always embed past practice. These practices have evolved mostly in the complicated domain and do not necessarily perform well in the complex domain, including in product development, research and innovation.

   Another problem with adopting socially acceptable forms of governance is that organizations implicitly limit themselves to whatever their competitors are doing. Successful organizations on the other hand break out of the mold, defining their own ways of working that better fit their strategy.

Conclusion

Governance is an important driver of organizational performance. Organizations which make good decisions, and which make those decisions in an efficient way, will be better placed to provide valuable products and services to their customers, citizens and other stakeholders. This applies to all aspects of an organization's operations, but it is particularly important in product innovation, where the rapid pace of change, high levels of uncertainty, and increasing trend towards complex, cross-organizational forms, can make decision-making especially challenging.

Good governance of product innovation also has considerable scope to improve societal outcomes. By considering the perspectives of all stakeholders affected by a product's design, manufacture, use and disposal, innovation teams can ensure that their products do not damage human or worker rights, and are environmentally sustainable throughout their lifecycle. This in turn benefits the organization—such products are more attractive to many consumers.

However, good governance only arises when an organization actively attends to and maintains its governance structures. When an organization ignores governance, ad hoc structures emerge. People spend a lot of time defining bespoke governance arrangements for each decision. At best, this creates inefficiencies. At worst, at leads to poor decision-making and allows inappropriate governance structures—bureaucracy, despotism and anarchy—to take hold.

In a world of rapidly moving technology, ever-greater micro-segmentation of markets and personalization of products, globalization of supply chains, and ever-greater competition, product innovation teams cannot afford to be constrained by inappropriate governance structures. Attention to governance is likely to become increasingly important for effective product innovation. In particular, governance models that support small, empowered, self-organizing teams to operate with rapid feedback loops and with clear awareness of and buy-in to wider organizational goals are likely to come increasingly to the fore.

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Discussion Questions

The authors claim to take a perspective as practitioners working within product innovation organizations, and hence present a number of observations about the forces which are driving change within such organizations. How well-founded are these observations? Identify other reports or research which examine today's context for product innovation and compare the factors they describe with those discussed here. How well do the models (e.g. of complexity and agility) discussed here fit with those other factors? What other theoretical frameworks might be relevant to the forces described here? What implications do these frameworks have for effective governance of product innovation?

Describe different models for governance of product development and the trade-offs they make against attributes such as speed and consistency of decision-making. Discuss how the most appropriate trade-off might vary as a product moves from the complex to the complicated and simple domains during the course of its lifecycle.

Describe ways in which good governance of the product innovation process can support the development of products that benefit society as well as the organization that developed them. Research examples that illustrate the benefits received by society and the product development organization through promotion of good governance throughout the product innovation lifecycle and supply chain.

The chapter promotes the thesis that product innovation in uncertain, fast moving environments happens most effectively when small teams are empowered to make local decisions with rapid feedback loops. Discuss the challenges this creates for global organizations with large product portfolios. How might other, more centralized, governance models be adapted to support effective product innovation?

How can individuals, teams and organizations recognise whether they are working in the complex or the complicated domain? What indicators would be useful?

The section on 'Models and Trade-offs' advocates creating different decision-making structures tuned to the characteristics of different decisions. This can lead to "decision making sprawl"—many decision-making bodies controlling different parts of the innovation process, with consequent costs to communication and coordination. Discuss the trade-offs between use of a single decision-making body for all decisions and defining different bodies for different decisions.

Key Terms

Accountability: The obligation for a person to explain and accept responsibility for their actions and decisions.

Agility: The ability of a product development method to create, embrace and learn from change while rapidly creating value for the customer.

Complexity: A state characterized by hidden, non-linear and cyclical causal relationships between a system's components and its environment. The behavior of a complex system is emergent: the system as a whole behaves in ways that cannot be extrapolated from the components.

Crowdsourcing: The practice of sourcing ideas and solutions from large groups of people ("the crowd"), typically via online forums.

Cynefin: A sense-making framework that helps decision-makers to understand their situation, and hence make better choices. Problems can be understood within one of four domains or contexts: *simple*, *complicated*, *complex* and *chaotic*. In addition, a fifth context of *disorder* captures those problems that cannot be easily characterized.

Governance: Governance determines who has power, who makes decisions, how other players make their voice heard and how account is rendered for decisions taken.

Open innovation: Identified by Chesbrough (2003) as "a paradigm that assumes that firms can and should use external ideas as well as internal ideas, and internal and external paths to market, as the firms look to advance their technology".

Uncertainty: A state characterized by limited knowledge, where it is impossible to fully describe the current situation and potential outcomes.

Authors Biographies

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CHAPTER 3

Rebooting Corporate Governance in India: Understanding the Journey through Institutional and Regulatory Landscape to the Landmark Companies Act 2013

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Abstract

India experienced its "Enron moment" with the Satyam scandal. Worldwide attention on corporate governance (CG) has been augmented especially in the context of current financial crisis. In India, the exceptional commitment was shown by the parliament toward corporate accountability and governance with the enactment of New Companies Act 2013. In the background of this extraordinary development, the chapter provides a synopsis of the nature of India's CG and examines the genesis and promises of reform efforts with special focus on two landmark developments in the field of CG—the CG sustainability guidelines 2009 (revised in 2013) and Companies Act 2013. It aims at appraising India's CG efforts to make business accountable and assess the noteworthy slips in the enforcement of the regulations. It makes an assessment of the legal and institutional aspects of investor protection and CG in India—both the letter of the law and the reality of its implementation. The chapter is based on (1) a diagnostic review of the legal and regulatory framework for CG; (2) the findings and recommendations of various commissions and expert groups appointed by GOI on CG; (3) underscores the distinctiveness of CG in India; and (4) spotlights on governments guidelines for sustainable development and mandatory clause of Corporate Social Responsibility CSR allocations and governance in the Companies Act 2013. This is indeed a path-breaking provision of the Act as India becomes the first country to take away CSR and sustainability from the zone of voluntarism to embed it in compliance/mandatory clause.

Keywords: corporate governance, agency problem, firm performance, regulatory authorities, Companies Act 2013, India.

Introduction

Robust CG structures and practices are prerequisite for resilient and vibrant capital market and are vital for investor protection. In the current context, the governments' worldwide is playing a catalyst role by constructing the structures of good governance for the ethical functioning of the companies. Second decade of this new millennium a mega trend is "responsible businesses." The consumer movement, environmentalists, and human rights activists have become increasingly empowered, and they vigorously publicize information of unethical conduct of companies. These, in turn, have tremendous political ramifications. The questions posed by these paramount concerns are essentially ethical: How do we advance a new moral, ethical, and spiritual foundation in business? How do we institute new essentials for business to help it chip in a more ecologically sustainable society? How can we construct a broader legal and institutional framework in which business can work to overcome the problems of fragmentation of responsibility and of inadequate or deficient moral and ethical accountability? The core of the predicament lies in the way in which economic institutions are structured. Thus, across a global community CG sits at the hub of developing a wider sustainable development program. If there is a persistent lack of trust for the business community to be allowed to manage the key resources, why should the community at large trust corporates to support the environmental and social aspects of the community?

It is very much in the interest of long-term business with the backdrop of stakeholders' dependence; that this development has been instrumental in introducing ethical business conduct. These have given structural legislative support to the development of guidelines for ethical business conduct, especially for multinational corporations. While the interest in business ethics has increased recently, the incomparable commitment shown by the Indian Parliament to CG and corporate social responsibility (CSR) with the New Companies Act 2013 by making it obligatory is noteworthy. The purpose of this chapter is to investigate the main issues surrounding ethics focused CG. Insights into how CG has emerged is provided as well as reflections as to whether firms are attempting to strike the right balance between regulatory and compliance-led processes, on the one hand, and improving their ethical governance by embedding the right corporate culture, on the other hand. Thus, the chapter examines the benefits of implementing appropriate and effective strategies in a firm's compliance processes. The chapter also considers both macro- and microeconomic conditions as well as changes in current world markets and therefore the governance of corporates.

India, since the late 1990s, has embarked on comprehensive CG reforms. Faced with a severe fiscal crisis in 1991, the Indian Government responded by enacting a sequence of reforms aimed at economic liberalization. The reforms in India were initially spearheaded by the corporate entities (CII), but then they quickly became significant component of the work of the Securities Exchange Board of India (SEBI), the primary regulatory authority for India's capital markets, and the Ministry of Corporate Affairs (MCA). Most noteworthy transformations in Indian CG became mandatory requirements for listed companies through the amendment of Clause 49 of the Listing Agreement of Stock Exchanges (Clause 49). The SEBI issued Clause 49 in February 2000 was amended in October 2004, and came into effect from January 1, 2006. However, the inadequacy in India's CG resurfaced again in the national debate in 2009 when the Indian corporate community was rocked by a massive scandal involving

Satyam Computer Services, one of India's largest information technology companies. As a consequence, India's ranking in the Credit Lyonnais Securities Asia (CLSA) CG Watch 2010 slid from third to seventh in Asia. The CLSA report stated that India "has failed to adequately address key local governance challenges such as the accountability of promoters (controlling shareholders), the reputation of related-party transactions, and the governance of the audit profession." Besides following the news of the fraud, Merrill Lynch terminated its engagement with Satyam, Credit Suisse, suspended its coverage of Satyam, and Price Waterhouse Coopers (PWC) came under intense scrutiny and its license to operate was revoked.

Satyam's scandal exposed the systemic failure from aspects such as a weak auditing process, ineffective board oversight through to a leader intent on committing fraud. However, at the same time, the scandal indicated an insatiable corporate greed and appetite for fraud. For corporate leaders, regulators, politicians, as well as for foreign investors, this "Enron moment" demanded a re-examination of the country's evolution in CG. The scandal served as a catalyst for the Indian government to revisit the domains of CG, disclosure, accountability, sustainability issues, and effectiveness of enforcement apparatus then in place. India has had several committees in the past that made recommendations for good CG and ethical practices, but the real concern relates to the practicality of these recommendations and the extent of their implementation in India. India continues to languish at the bottom of the World Bank's popular enforcement scale (World Bank/IFC 2011). More recently, in 2011, another multibillion dollar telecom scandal involving alleged irregularities in the awarding of 2G spectrum licenses has dominated newspaper headlines worldwide (Economist 2011; Lamont and Fontanella-Khan 2011). Then the coal sector scam surfaced; yet again, revealing the nexus between politicians and corporates and the complete disregard for natural resources. A series of scams points toward the fact that India is in the throes of a governance crisis.

In this background of rampant corporate malfeasance, fraud and unscrupulous practices, and being harassed with international pressure to standardize the procedures for foreign investment, new laws were conceptualized primarily to make business responsible and to plug loopholes in the system that were causing a serious trust deficit in the market. This long-awaited Companies Bill 2013 got its assent in the Lok Sabha on December 18, 2012 and in the Rajya Sabha on August 8, 2013 (Lok Sabha and Rajya Sabha are the lower and the upper houses of Indian Parliament, respectively). After having obtained the assent of the president of India on August 29, 2013, it has now become the much-awaited Companies Act 2013, which becomes applicable from April 1, 2014.

Capitalism and Falling Apart of Corporate Governance—An Indispensable Disquiet

A notable number of high-profile corporations and financial institutions (FIs) have experienced substantial collapse in the last decade, predominantly because of corporate malfeasance involving executives and their association to the responsibility of their company's board. The bankruptcy of Lehman Brothers Holdings and the collapse of Bernard Madoff Investment Securities in the United States, SociétéGénérale's trading losses, and the Swiss-based global financial services firm UBS AG in Europe, to mention a few but also Goldman Sachs & Co., J.P. Morgan Securities are just a few of the formerly illustrious having hit the headlines in the last few years. This not only has put a spotlight on CG issues from an international point of view but also demonstrates how the efficiency of the economic markets is coupled with and based upon a conjuncture of trust and ethical conduct. The 21st century is declared as the century of CG by a number of academics, policy makers, and activists. Corporate governance is now an international topic due to globalization of businesses. (McNutt 2010; Tricker 2009). More than ever before, reforms require that the governing authorities of businesses need to be well informed about the content and practice of their ethics with regard to its implementation and its effectiveness in their day-to-day business processes. In addition, there are challenges of "tightening" CG, which certainly means to ensure increased compliance with specific standards and practices recommended in national and international governance codes and guidelines.

Cliché though it sounds, financial scandals all over the world underscore the mounting consequences of poor or ineffective CG. All regulatory escapes assure a focus on governance issues, especially transparency and disclosure, control and accountability, and to the most apposite form of board structure that may be competent and confident of preventing scandals from occurring in future. The connection between CG reforms and recession is also cyclical, with waves of reform and increased regulation occurring mostly during or after the periods of recession, corporate collapse, and re-examination of the viability of regulatory systems. During long periods of expansion and growth, both companies and shareholders are completely occupied by euphoric generation of wealth rather than in ensuring that sustainable and robust governance mechanisms are in place. This capitalist overdrive leads to waning of vigorous attention on governance and regulation. The recent global financial crisis, in that sense, has brought to the forefront the significance of a sound CG system as a crucial element of effective and sustainable management for the companies and for the nation at large. Development, inclusivity, and sustainability are rallying points in global discourse. The questions being asked is has the model of development been rigged in favor of few with large parts of humanity getting peripheralized?

The legitimacy of business has fallen to levels not seen in recent history. This diminished trust in business leads political leaders to set policies that undermine competitiveness and sap economic growth. According to Porter and Kramer, a big part of the problem lies with companies themselves, which remain trapped in an outdated approach to value creation that has emerged over the past few decades. They continue to view value creation narrowly, optimizing short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success. How else could companies overlook the well-being of their customers, the depletion of natural resources vital to their businesses, the viability of key suppliers, or the economic distress of the communities in which they produce and sell? (Porter & Kramer, 2011) Ruggie, the U.N. special representative to the secretary general for business and human rights, reported to the U.N. General Assembly in (Ruggie 2007) that there is a "dystopia" that "states and businesses need to consider and avoid as they assess the current situation and where it might lead. Sustainable businesses incorporate four interrelated but distinct conceptual components: economic sustainability, social sustainability; ecological sustainability; and now increasingly emphasised ethical and human rights aspects." In a way triple bottom line is expanding in to incorporate the fourth aspect of ethical governance; therefore, *quadruple bottom line* may be the new nomenclature to encompass the facets of sustainability. Although not the only cause, governance failings are momentous where boards or management fall short in their comprehension and management of risk and put up with perverse incentives. The crisis necessitates the improvement in the general business sector approach toward CG, transparent functioning, and risk management, as well as the value of social and ethical accountability for reinstating trust in global economic order.

For more than two decades, a debate has raged among scholars interested in corporate law, governance, and finance about how control over key corporate decisions should be allocated between shareholders and directors. CG has attracted a great deal of public interest because of its apparent importance for the economic health of corporations and society in general. CG can be conceptualized in broader terms as the set of checks and balances within the corporate structure that address agency problems and help enhance long-term sustainable value for all stakeholders in a company (Monks and Minow 2011). Most cross-country studies on CG shine a spotlight on the interaction between economic performance and countries' different legal systems, predominantly the level of investor protections. Thus, developing a "code of ethics" (CoE) for industry is all about synthesizing the present situation in the eyes of ethical and nonethical subjects that arise in a business environment. As an imperative need the business needs to adopt "economic sustainability," "social sustainability," "ecological sustainability," and "ethical aspects." Interestingly, while we have well-developed mechanisms to measure performance on the economic and ecological parameters, criteria for the other two, i.e., social and ethical aspects have yet to reach the same level of superiority and comprehensive coverage. Increasing complexity and interdependence require new approaches.

In the United Nations Global Compact Report 2012 titled "A Practical Guide to the United Nations Global Compact for Higher Education Institutions: Implementing the Global Compact Principles and Communicating on Progress," it is suggested that companies everywhere to voluntarily align their operations and strategies with 10 universally accepted principles in the areas of human rights, labor, environment, and anti-corruption, and to take action in support of U.N. goals, including the Millennium Development Goals. Companies need integrative management tools that help embed these concerns into their strategic thinking and daily operations. In 2007, the Principles of Responsible Management Education (PRME) initiative was launched at the Global Compact Leaders' Summit in Geneva, with the goal of instilling the principles of the Global Compact into business schools and their curricula. PRME's mission focuses on management education and the institutions and programs that teach in this field. Its particular emphasis is placed on curriculum, instruction, and research. PRME has grown into a significant movement, more than 400 member institutions from over 60 countries.

The first level of responsibility, which is common to all organizations, concerns social, environmental, and economic performance dimensions:

- *Social*: Working conditions of staff, diversity policy, social dialogue, integration of stakeholders, training, governance, and so on.
- *Environmental*: Transport and building policy, responsible purchasing, policy concerning reduction of greenhouse gas emissions, and so on.
- *Economic*: Territorial, investment policy, green business, contribution to the community, sustainable development performance indicators, and so on.

The second level of responsibility is to produce socially responsible citizens who include sustainability issues in their professional management decisions and take part in developing socially and environmentally responsible, ethical companies (United Nations Global Compact Report 2012).

The question is how should the threshold be determined, particularly when business contexts vary from organization to organization. Conversely, what is also often missed is the actuality that governance engagements that are optimal for investor protection in one country could be suboptimal for companies in another. For instance, the levels of ownership concentration at which owners are more likely to expropriate minority shareholders vary from country to country, depending on the regulations and the level of enforcement. Accompanying this, in some situations, "friendly" outside directors may also be trust worthier and more clued-up than "independent" directors. So there are complexities and nuances involved in these emerging paradigms that have to be addressed to ensure effectiveness in governance systems at a global and a local level.

Two key aspects have lead to brisk improvement in CG field, namely, the integration and globalization of financial markets and a surge of corporate scandals such as Enron, WorldCom, and more recent economic downturn (as mentioned earlier) that has brought the spotlight on the fundamental functioning and principles of the much revered capitalist model. Falling stock markets, corporate failures, dubious accounting practices, abuses of corporate power, executive compensation, backdated stock options, and criminal investigations indicate that the entire economic system upon which investment returns are based are showing signs of stress that has undermined investor's confidence and has had serious political repercussions. Major protests around the world since 2009 are symptomatic of the malaise and disregard of society by businesses that many perceive. While some failures were the result of fraudulent accounting and other illegal practices, many of the same companies exhibited actual CG risks such as conflicts of interest, inexperienced directors, overly lucrative compensation, unequal share voting rights and more significantly the unsustainable business practices, toxic waste disposal and hazardous methods of manufacturing being adopted, and total discard to the bottom of pyramid. By 2009, 23 developed countries and 43 developing/emerging economies had come up with best practice governance codes and principles either through private or government initiatives, some mandatory, and some nonmandatory. Subsequent to the first round of codes, almost all countries followed up with other codes, either updating the older codes, or issuing fresh ones (Sarkar and Sarkar 2012).

In the face of such scandals and malpractices, there has been a renewed emphasis on CG and ethical management. Most recently, Brazil, Russia, India, and China (BRIC), the so-called the emerging countries, have come into sight as influential economic players in the global economy. Perceptibly the landscape of ethical corporate is particularly problematic as the field is becoming measureless, often encompassing such concerns as reputation management, accurate accounting, fair labor practices, human rights, environmental stewardship, and in some countries it has also been linked to distributive justice and inclusive development to name only a few. So, in the era of globalization and liberalization, governance of corporates remains a key risk factor for investors in emerging markets and significant determinant of portfolio investment decisions. This is the case at both the country level, where rule of law, regulatory quality, and corruption are key drivers for country-level risks, and at the firm-specific level, where controlling shareholders (state, families, or other financial or industrial groups) play a critical role and are a source of strength or weakness, thereby tolerating or even exacerbating an already unequal playing field. Correspondingly, a broad array of increasing risks coupled with the complexity of supply chains has impelled companies to bring in strategic ethical monitoring mechanisms across their supply chains to shield corporate reputations. To quote the Ruggie report, "Companies have had to acknowledge that business as usual is not good enough for anybody, including business itself" (John Ruggie's Report on Business and Human Rights 2010). These, in turn, have tremendous political ramifications in India. These groups have put operations of many multinational and Indian corporations under scrutiny. A number of instances of similar human rights and corporate ethics abuses including grave human rights violations can be cited throughout India. One of the most potent incidents has been the Bhopal Gas Tragedy, 1984. "It has been 26 long years since one of the world's worst industrial disasters struck Bhopal. However, even today, most of the victims await justice. They demand the companies to have appropriate Code of Ethics (CoE); to end the use opportunistic and discriminatory business practices; or to establish fair wage policies for the local employees, or to have the clear-cut public relation norms so far as paid news and derogative advertisements are concerned, etc." Code of corporate ethics is one of the pioneering endeavors in India, which does not have a comprehensive CoE for Indian industry. A corporate CoE that outlines the role of the State in preventing and remedying human rights violations caused by private companies (whether of foreign ownership or otherwise) is vital in any country (Developing CoE for Indian Industry 2012). By adopting the National Human Rights Commission (NHRC) CoE, Indian corporates would follow the lead of hundreds of multinational corporations that have adopted the U.N.'s "Protect, Respect and Remedy" framework.

Global networks of codes of conduct both at company and sectoral level could counteract competitive "race to the bottom" tactics, and lock key suppliers into a commitment to raise rather than lower labor standards (Jenkins et al. 2002). In a way, the Global Compact is the world's largest corporate citizenship initiative and as voluntary initiative that works toward two primary objectives: (1) "Mainstream the ten principles in business activities around the world," and (2) "Catalyze actions in support of broader UN goals, such as the Millennium Development Goals (MDGs)" (UN Global Compact 2010). Nevertheless, the universalistic and generalized approach assumed by corporate codes of conduct is questioned. Instead, a particularization of codes based on the complexity of supply chains and consideration of specific contexts definitively increases the inclusion and representation of the interests of those the codes are supposed to represent. Putting aside questions regarding the strengths or weaknesses of these instruments, the quick and steady growth of companies that have adopted CSR mechanisms has been impressive. CSR leverages the unique expertise and resources of the company to create economic value by creating social value. By the end of 2007, the U.N. Global Compact, the world's largest CSR initiative, had approximately 3,600 participating companies, out of what UNCTAD estimated to be a total of 78,000 transnational corporations (TNCs) and 780,000 affiliates operating worldwide (UNCTAD 2007). For example, it is becoming ever more frequent to see private businesses undertake social, environmental, and economic responsibilities, such as establishing charitable trusts, foundations, and mega institutions by running community development programs and forming partnerships with the government or NGOs in India. Organizations such as Bharath Petroleum Corporation Limited, Maruti Suzuki India Limited, and Hindustan Unilever Limited adopt villages where they focus on holistic development. They make available improved medical and sanitation facilities, build schools and houses, and help the villagers become self-reliant by teaching them vocational and business skills. Numerous examples can be specified from the corporate side, such as a large proportion of the profits of the Tata Group companies, for example, go to its charitable foundations and back into Indian society. The Godrej Group has constructed schools, medical clinics, and living facilities for employees. Thus, through the years, the corporate entities have redefined their objective of "profit maximization" to "profit optimization." In short, over the course of the last decade and a half, agendas of ethical trade and consumption, together with associated agendas of corporate responsibility and accountability, have been expanding and consolidating across both "barricades and boardrooms" throughout the world (Bendell 2004).

Variation is also significant within each of these clusters of CSR activity. Corporate codes of conduct, for example, vary widely in their scope, in the range of standards they encompass, and in the degree of transparency and worker participation associated with processes of code design, implementation, monitoring, and verification (Jenkins et al. 2002). There is also some variation in the scope of the responsibilities they encompass—whether they regard responsibilities of Northern businesses and consumers to extend simply to workplace issues related directly to the process of production of goods and services, or whether they encompass broader social and developmental responsibilities that would encompass "the production and reproduction of labor power in the global economy" (Jenkins et al. 2002). Overall, the picture is generally agreed to be one of extreme unevenness in the scope and substance of protections or benefits offered as a result of the CSR agenda (Jenkins et al. 2002). In concrete terms, such differing normative views have been given expression in models of corporate responsibility of divergent kinds. At one end of the spectrum are the clusters of wholly voluntary and business-led initiatives such as individual company codes of conduct, which may include brand, retailer, or in some cases factory-based codes or industry association codes and further along the spectrum again are those initiatives that seek to build legal frameworks for corporate responsibility.

Typically Asian?—Appreciating the Nuances of Corporate Governance in This Region

The prevalence of a specific governance system in a country at any point of time is the product of its history. As corporate governance evolved over the past twenty or thirty years, the so-called Anglo-Saxon approach (unitary boards—with executive and non-executive members) was frequently contrasted with the continental European approach (two-tier boards separating supervisory and executive responsibilities) or Asian approaches (Japanese *keiretsu*, Korean *chaebol*, and Chinese family-orientated company boards). Country-level experiences have shown that changes in economic environment as well as changes in cultural, political, and legal institutions have impacted the evolution of ownership structures and governance systems. In general, as several scholars have argued, a country's pattern of ownership structure and national governance systems are path dependent, being politically and historically contingent and continuously shaped by the "shadow of their unique histories (Gilson 1996)." An important implication of such path dependency in the context of reforming governance systems, particularly in emerging economies, is that while the general approach has been to imbibe international best practices, a host of political economic, cultural, and other informal institutions have militated against their convergence to such practices. This is highlighted in the cross-country evidence (Khann et al. 2006), which shows while there have been *de jure* similarities in systems between countries whereby both developing and developed countries adopt similar governance standards, there is no statistical evidence to suggest *de facto* convergence of CG in terms of implementation of the standards level (Sarkar and Sarkar 2012). Institutional economists view cultural values as the informal rules of the game (North, 1990) that define culturally fitting decisions and behaviors and thus constitute the most fundamental level in a stratified system of institutions (Williamson, 2000), shaping how more precise institutions develop (Greif, 1994). Hayek (1973) also insisted that law "is older than legislation" and that law "in the sense of enforced rules of conduct is undoubtedly coeval with society." Statutory legislation is regarded as a ratification of prior customary arrangements and many theorists use game theory to show how interacting individuals give rise to legal and other "self-enforcing" institutions through the establishment of (Nash) equilibria in the game (Aoki 2001; Schotter 1981; Sugden 1986) In particular, an alternative to the Anglo-American paradigm is the *relational paradigm* characterized by bank financing and monitoring, large blockholders, crossholdings, and weak markets for corporate control (Aguilera and Jackson, 2003; Yoshikawa and Rasheed, 2009). However, it must be stated here that certain features that are common to all countries that contributed to the varying types and pace of the CG norms include the following: accidents of history, ideas, families, business groups, trust, law, origins, evolution, transplants, large outside shareholders, financial development, politics and entrenchment, and so on.

Ownership structure has vital implications for CG and protection of minority shareholders' interest. Concentrated ownership structures and affiliation of companies with business groups is a common feature of Asian economies (Claessens and Fan 2002). Recently a growing amount of empirical work has been done for emerging economies including India. Claessens and Fan (2002) provide an excellent survey on CG in Asia. In Asia, as in most other emerging markets, families typically control groups. While, following the East Asian crisis, family managements have come under severe criticism; subsequent empirical exercises suggest that they do have certain merits. Another study of Thai firms finds that family-controlled firms, foreign-controlled firms as well as firms with more than one controlling shareholder are associated with better performance, relative to firms with no controlling shareholder. The controlling shareholders' involvement in the management, however, has a negative effect on the performance (Wiwattanakantung 2001). According to Khann (1999), performance effects of group affiliation in India are by and large positive because groups could be substituting missing and poorly functioning institutions. Furthermore, Khann and Palepu (2004) argue that concentrated ownership in India is not entirely associated with the ills that are ascribed to it in emerging markets. As a response to competition, at least some Indian families are seen to have tried to leverage internal markets for capital and talent inherent in business group structures to launch new ventures in environments where external factor markets are deficient. Thus, concentrated ownership was found to be a result, rather than a cause, of inefficiencies in markets (Chalapati Rao and Atulan Guha 2007).

CG practice and procedures underwent significant changes during the period 1997–2007 in Asia. From 2003 onward, CLSA and Asia CG Network together collaborated in bringing performance scores of countries in the Asian region with regard to CG. The first of the report, CG Watch 2003, had an interesting title, "Faking It: Board Games in Asia" perhaps most appropriate at that time in the background of global meltdown of stock markets brought about by severe inadequacies and abuses in corporate conduct and disclosure standards. The 2004 report had a more promising title "Spreading the Word—Changing Rules in Asia" reflecting changing landscape of the CG brought out in the backdrop of Sarbanes-Oxley and a host of regulatory reforms that came into being a number of countries. The CG Watch 2005 had the title "Holy Grail: Quality at Reasonable Price (QARP)" showing growing commitment toward better CG. The 2007 report had a much more encouraging theme "On a Wing and a Prayer: Greening of the Governance" that brought out the significant changes in the CG practice in the Asia region (Allen 2007).

Numerous factors have proven to be fundamentally vital in shaping firms' governance choices in countries of emerging markets. Let me just name a few. The quality of public governance impinges on the level of law enforcement and extent of corruption. These aspects weigh on the quality of CG and corporate transparency in a country. Compliance with the law and the avoidance of bribes can be a source of competitive disadvantage in countries where compliance adds to the operating costs and runs counter to business norms that tolerate bribery. In countries where state ownership is widespread, the incentives and the quality of government officials and regulators are key determinants of corporate behavior. For instance, state ownership is linked with better performance in some countries, such as in India; in others, such as in Turkey, the correlation is negative (Allen 2007). Market competition, although recurrently considered a positive influence on CG practices, is commonly far from perfect in emerging markets, particularly in protected sectors. Financial market development is recurrently weighed down by fragile legal practicalities and enforcement. This distinction depends on the impetus for the emergence of business groups in the first place, which varies from tax optimization to lowering transaction costs to diversifying risks.

There is also a concern of how these group structures are synchronized. In India, under the Company Law, a company can hold as many subsidiaries as it likes, but a subsidiary cannot act as the holding company of another company. These provisions aim at preventing private control over public companies through pyramidal structures. Ownership structures establish the nature of the relationship between the board and performance.

In many emerging economies including India, controlling families occupy managerial positions in listed firms, and succession planning is frequently focused on family members and not on professional managers. Family presence, especially the founders' presence on the board, is associated with better performance in some countries where associations matter more and the business elite are securely linked (Chakrabarti, Megginson and Yadav 2008). Established econometric research provides comparatively little assistance on these intricacies, as the interplay between institutions and their consequence on performance outcomes is incredibly tricky to model. Therefore, any governance meta-theorizing and modeling has to include "the variance factor" keeping in mind the cultural and historical context of that particular country.

Revisiting Agency Theory and Bringing Back the Quintessential Issue of Ethical Governance

The problems of governance can be traced back to origins of the corporate form as early as in 800 BC (Khann 2006), and more recently to the prototype modern corporation of Berle and Means (1932). There are also no qualms now that CG is possibly one of the most significant differentiators of a business that has impact on the profitability, growth, and even sustainability of business. It is a multi-level and multitiered process that is distilled from an organization's culture, polices, values, and ethics especially of the people running the business and the way it deals with various stakeholders. Creating value that is not only profitable to the business but also sustainable in the long-term interests of all stakeholders necessarily means that businesses have to run and be seen to be run with a high degree of ethical conduct and good governance where compliance is not only in letter but also in spirit. The *Anatomy of Corporate Law* (2009) suggests that corporate law aims "to advance the aggregate welfare of all who are affected by a firm's activities including the firm's shareholders, employees, suppliers, and customers, as well as third parties such as local communities and beneficiaries of the natural" (Kraakman et al. 2009, 28). While there are numerous ways to conceive of how these aims can be achieved, an approach common in the "law and finance" literature is that corporate law seeks to do this through the maximization of shareholder returns (Kraakman et al. 2009). CG can therefore, in economic terms, be most usefully seen to deal with constraints that managers put on themselves, or that investors put on managers, ex ante, to reduce the misallocation of resources ex post (Shleifer and Vishny 1997).

Corporate law achieves two wide ranging functions: *first*, it institutes the structure of the corporate form as well as ancillary housekeeping rules crucial to maintain the structure; *second*, it attempts to manage conflicts of interest among corporate constituencies, including those between corporate "insiders," such as controlling shareholders and top managers, and "outsiders," such as minority shareholders, creditors, and other stakeholders. These conflicts all have the disposition of what economists refer to as "agency problems" or "principal-agent" problems, in which one party (the 'agent') promises performance to another (the 'principal'). The core of the difficulty is that, because the agent commonly has better information than does the principal about the relevant facts, the principal cannot easily assure himself that the agent's performance is precisely what was promised. As a consequence, the agent has an incentive to act opportunistically, skimping on the quality of his performance, or even diverting to himself some of what was promised to the principal. This means, in turn, that the value of the agent's performance to the principal will be reduced, either directly or because, to assure the quality of the agent's performance, the principal must engage in costly monitoring of the agent. The greater the complexity of the tasks undertaken by the agent, and the greater the discretion the agent must be given, the larger these 'agency costs' are likely to be. (Armour, John and Hansmann, Henry and Kraakman, Reinier 2009).

Moral hazard is the precise predicament that agency theory is designed to address through a range of mechanisms—most markedly incentives and monitoring (Eisenhardt 1989). The projected apparatus for limiting moral hazard are usually monitoring and incentive contracts (Jensen 1993; Daily et al. 2003), where the board of directors (BOD) comprises the foremost monitoring mechanism. The monitoring system offers an ex post control structure (Jensen and William 1976, Fama & Jensen, M.,. 1983), where the scope of the monitoring in place will reckon on the proclivities of management for opportunistic behavior and the costs and benefits related to its implementation (Jensen and William 1976). There are also ethical insinuations in agency theory's definition of the firm as a "nexus of contracts." Since the early 1970s, the mainstream literature has viewed the firm as a nexus of bilateral contracts between the suppliers of different assets: equity capital, debt finance, labor, materials, and custom. The rationale for the existence of the firm is taken to be the minimization of costs—for example, supervision and monitoring costs (Alchian and Demsetz, 1972), and transaction costs (Williamson, 1975, 1985). Jensen and Meckling state that this definition avoids the "personalization" of the firm as a whole, and places the responsibility for the firm's actions squarely on the shoulders of the agents who made the decisions. Critics of the definition feel it de-emphasizes the role of ethics in the development of corporate policies and promotes a "value-free" practice of financial decision making. Horrigan claims that agency theory ". . . raises the ethical danger of creating a very contentious, litigious view of financial relationships, pitting agents against principals and principals against principals as perpetual adversaries many business ethicists and practitioners, for example, continue to rely on deontological principles in their approach to ethics." Dobson (1991) agrees that "By *assuming* unbridled self-interest, financial economics *promotes* unbridled self-interest." This significantly informs their understanding of how individual employees and organizations come to do the things they do. The cogency of deontology relies on the capability of human beings to formulate decisions in dispassionate and unbiased ways, which presume a certain rational aloofness in moral deliberation. Donaldson and Dunfee's social contract theory approach suffers from the same kind of appeal to abstract rationality. This version asserts that the business enterprise is characterized by a myriad of "extant social contracts," informal agreements that embody "actual behavioral norms which derive from shared goals, beliefs and attitudes of groups or communities of people" (Dunfee 1991). These extant social contracts represent the view of the community concerning what constitutes proper behavior within the confines of the community. Together, the works of philosophers such as Nietzsche, Heidegger, Marx, Marcuse, Horkheimer and Adorno, as well as a host of others call into question the idea that a moral agent can make sense of things objectively, through an act of rational detachment. They not only dispute the possibility of doing so but also draw attention to the various negative implications of continuing to in believe in it. Many of the downsides of governance and greed ascendancy can be coupled with this "highly distanced rational actor" approach.

Strongly related to the subject of bonus schemes is the perception that contemporary CG has been unsuccessful in safeguarding the firm (Jickling 2010; Blundell-Wignall et al. (2008); Foong (2009) also pointed to fragile CG mechanisms to elucidate the effectual failure of the market. Organization for Economic Co-operation and Development OECD (2010) provided analogous assessment, describing a system that failed to provide and cultivate sound business practices. Professor Hasung Jang posited that akin to the 1997 Asian financial crisis, inadequacies in CG were a starting place of the current global financial crisis (Jang in Sharma 2008). Others point distinctively to the broad-spectrum ineptness of boards to stem incessant risk-taking behavior (Dobbin et al. 2010; Abdullah 2006).

Another evaluation in the light of the contemporary global financial crisis has been that, just as the principal may learn which incentives work the finest, the agent learns which aspects of performance the principal is interested in and primarily seeks to optimize these exact aspects (Shapiro 2005). The outcome is a system where everything is driven toward meeting measurable targets and not necessarily toward creating real value and growth (Porter, 1992). The capitalist system has thus come under siege. In recent years, business increasingly has been viewed as a foremost reason of social, environmental, and economic harms. Companies are widely alleged to be prospering at the expense of the broader community (Porter and Kramer 2011). Polanyi (1944) argued famously that market institutions create incentives for firms to pursue their self-interest but that doing so in unbridled fashion will destroy the economy. As noted by Krugman (2008) in the New York Times, "the average salary of employees in "securities, commodity contracts, and investments" was more than four times the average salary in the rest of the economy. The pay system . . . lavishly rewards the appearance of profit, even if that appearance later turns out to have been an illusion." Sidelsky (2009) contended that bankers, though also self-interested, acted largely in accordance with the adage of the system profit maximization. Priester (in ALDE 2008) criticized the proclivity of business models toward short-term wealth maximization as "fundamentally flawed" on the grounds of being both "economically obsolete" and "morally indefensible" by transferring all power to the shareholder. The point is that for markets to function well institutions must compensate for each other's shortcomings rather than reinforce each other's incentives (Crouch, 2010). From an ethics perspective, he further argues that the permeation of economic theory has dehumanized business and only heralded innovation for the purpose of private gains, when in fact "innovation is for-or-about serving the substantive interest of the Human Person." Shapiro (2005) argues that the agency theory perspective is a "*peculiar way of understanding the social reality*," that the suppositions therein are disconnected from actuality and solely made in order for the model to be workable scientifically. "The need for leaders who know how to make a difference in the world has never been greater than it is today", wrote Dean Jay Light of the Harvard Business School (2009) "The need extends beyond business to the social, government, and non-profit sectors as well . . . qualities that are fundamental to good leadership (include) judgment that leads to sound decision-making, an entrepreneurial point of view, the ability to listen and communicate effectively, a deep sense of one's values and ethics, and the courage to act, based on those values and ethics." The "rules versus principles" dilemma has been amplified by the ongoing global financial crisis.

This directs to an oversimplified way of characterizing and resolving troubles in the organizational condition that may be potentially precarious. Shapiro (2005) continues by arguing that the intrinsic disbelieve apparent in contemporary theory of governance has led to a dehumanization of the agent, where the inherent motivations are ruthlessly replaced with a rational calculation of the value of consequences and reduced the firm to a dyadic contract between individuals (Ghoshal 2005). This has been harmonized by the advancement of a system based on formal rules, which have crowded out customs and ethical principles previously found in a relational society Coleman (1993); Heath (2009) and Brennan (1994) question the theory's disregard for altruistic behavior as well as the continuous distrust and suspicion derived from opportunistic inclinations. As more companies espoused the agency logic, the logic became institutionally overriding (Zajac et al. 2004), which meant that with the mounting expectation of people behaving with opportunism actually led to a self-fulfilling and amplifying social cycle of people behaving opportunistically and expecting or assuming the same of others (Armour, John and Hansmann, Henry and Kraakman, Reinier 2009).

Thereby events in the world's financial, food and energy markets, global recession, as well as the urgency of climate change, growing inequality, and persistent poverty suggest that various features of globalization and economic liberalization are fundamentally flawed in governance terms. They also starkly contradict the development scenarios of those who had been touting the virtues of self-regulating markets, minimalist states, and the capacity of large firms to recast their role in society through "corporate social responsibility." A widespread outlook on the debate on corporate social and environmental responsibility is that society has become ever more vociferous and demanding on its insistence that the business sector must contribute to social and economic prosperity in the long and sustained term. Currently, interconnected civil society activism and surveillance networks provide an inducement to companies to behave well since antibrand websites, twitter counterattack, and e-mail campaigns can have a dramatic impact within a few days. Protest demonstrations are perhaps the quintessential tactic used by social movements who are outsiders to the corporation. Global brands are now highly vulnerable to "internetworked" protests around the world. (Klein 2000; Taylor and Scharlin 2004).

Sustainable development is now "replete with governance questions." This is because sustainable development requires simultaneous consideration of each of the social, economic, and environmental "pillars" of policymaking. Hopkins (1999) suggests that in order to reverse the negative consequences of globalization, there is a need for a "planetary bargain" between the public and the private sectors. Many have even come around to the idea that ethics is something that has to be institutionalized, resourced, and managed. In the face of this wave of unprecedented interest, many business ethicists have concluded that the business community no longer sees business ethics as an oxymoron. In fact, an investment in business ethics has become a prerequisite for an organization's continued participation in formal business networks (Morland and Painter 2010). The introduction of stricter legislation and other forms of regulation have imposed new parameters on business activities and have bolstered the case for ethics interventions in organizations. Transparency is said to be more "sustainable" than corruption. Good employment practices are more "sustainable" than sweatshops. Mere philanthropy may not contribute to the sustainability of a society. Many corporate ethics programs have become no more than "insurance policies" against corporate liability and are implemented and managed with an indiscriminate "checkbox" mentality. In addition, prepackaged business ethics strategies often rely on the institutionalization of standardized codes and compliance procedures. These codes and procedures are not tailored to reflect the unique sensibilities that may have developed within a particular organization or the expectations and dynamics that exist within specific industries. This limits their relevance and ability to effect change (Morland, Painter 2010). Ethics surveys and climate studies are regularly employed, but are mostly incapable of detecting or describing the tacit, unwritten rules that are the primary source of moral orientation in many organizations. These are true assertions; however, they offer little basis for balancing long-term objectives against the short-term costs they incur. In fact, we need to ask some critical questions in the light of sustainability movement—Is the strategy to go to sustainable development a real strategy to avoid the impact of global warming, avoid future extra costs, risks to insure, and guarantee future growth and profit, or simply marketing issues to capture the market most sensitive to sustainable development and who are willing to pay extra money to obtain a "green" product? An emerging paradigm, therefore, has to define responsible and sustainable business as an ability to embed an understanding of "relatedness" into all of their decisions, actions, and evaluations. This enables it to acquire responsibility for the body of the whole, including the global community and the planet.

Beyond Regulatory Labyrinth: A Literature Review on Unremitting Constraints and Distinctiveness of Corporate Governance in India

The governance of the execution of CG is, historically, attached with the "holy trinity" of "rights, transparency, and board accountability" along with long- and short-term risk planning. The prime onus of implementing fair CG practices lies with the BOD of a corporation. They are responsible for formulating transparent and honest board structures (where independent directors hold authority); deciding fair executive remunerations and also ensuring extensive reporting of financial and nonfinancial activities, to the shareholders. However, these CG frameworks differ significantly in different countries and jurisdictions. This ranges from a policy toward high compulsion for CG (as in the case of the United States), to a "comply or explain" scenario (like in the United Kingdom) and finally to regions where the CG implementation is in its nascent stages (like in India and other South Asian economies) (Calder 2008).

Of late, international narratives on governance have begun to document key characteristics of CG in India. It is extraordinary but factual that early initiatives for better CG in India came from the more enlightened listed companies and an industry association. This was fairly dissimilar from the United States or Great Britain, where the drivers of CG were shareholders' groups, activist funds, and self-regulatory bodies within capital markets, or South-East and East Asia, where the impetus for better governance was the product of circumstances imposed by the IMF and the World Bank in the wake of the financial collapse of 1997–1998 (Goswami 2003). True, there were three financial scandals that highlighted the requirement for better corporate transparency and accountability, and these brought the phrase "corporate governance" into the lexicon of the financial papers. Nevertheless, it is astonishing to note in hindsight that there were no major internal or external pressures that could have created urgency for better CG.

The western approach to CG focuses on regulating management actions to align them with the interest of stakeholders, as ownership is reasonably dispersed. This is the classic agency problem, but in India the agency problem primarily exists between the dominant/majority shareholders. Family business promotional firms also dominate Indian businesses where the family members exercise disproportionate control. Even in the case of multinational corporations and public sector enterprises (PSEs), the majority shareholders have been found to exercise dominant control. The underlying characteristics of this system need to be researched and identified, so that the CG framework can be fine tuned to Indian and global needs. While the efficacy of "transplanting" Anglo-American models of CG to the Indian context has been questioned (Verma 1997; Reed 2002; Varottil 2009), there has to date been little research into alternate "home-grown" forms of CG.

Citing from what is possibly the most influential “law and finance” study on the subject, La Porta et al. (2000) point out that the expropriation of minority shareholders and creditors by controlling shareholders can take a variety of forms including the following: stealing profits; selling outputs of the firm, its assets or additional securities in the firm they control to another firm they own at below market prices (transfer pricing, asset stripping, and investor dilution, respectively); diverting corporate opportunities from the firm; installing possibly unqualified family members in managerial positions; or overpaying executives. While La Porta et al.’s study did not cover India, there is evidence in the empirical literature of each of the aforementioned forms of expropriation in India. For instance, “tunneling,” a form of diversion in which controlling shareholders in a business group move funds from group firms in which their ownership stakes are low to firms in which their ownership stakes are high, is believed to be common in India (Bertrand, Mehta and Mullainathan 2002; Chakrabarti, Megginson and Yadav 2008).

The three different kinds of firms: public sector enterprises, multinational corporations, and family businesses, and they have their own distinctive features and public perceptions in India. PSEs are accountable to the relevant minister, need to comply with norms laid down by department of public enterprises, and are subject to scrutiny under the Right to Information (RTI) act and other authorities such as comptroller and auditor general and chief vigilance commissioner. PSEs, though subject to controls, operate in a relatively complex setting. In general, public sector firms are argued to be less efficient than private sector firms (in relatively competitive markets) due to low powered managerial incentives and interest alignment. There could be “political” reasons, as government pursues multiple objectives, some of which, unlike profit maximization, are hard to be contracted upon. The multinational companies (MNCs), on the other hand, are perceived as the most sophisticated in terms of CG, as they are required to comply with the standards set down by the parent company. However, even MNCs have had instances where they have made an attempt to acquire minority shareholding at unfair valuations and have been responsible for a number of violations of, for example, labor laws and environment standards. Cases like the Bhopal gas tragedy; the role of union carbide; Dow Chemicals; the Platchimada struggle by tribals against Coke in Kerala; the tribal protest against Vedanata's Alumina factory in Niyamgiri, Orissa; and the land acquisition issues in Singur and Nandigramall illustrate gross human rights violations by corporates due to the absence of a mandatory CoE. Family businesses are dominant in the Indian market landscape, as shown in the study by Credit Suisse in 2010. The study showed that 663 of the 983 listed companies are family businesses. According to *Business Today*, family-run businesses account for 25 percent of India Inc's sales, 32 percent of profits after tax, almost 18 percent of assets, and over 37 percent of reserves. They exercise undue control over a company either directly through the promoter family stake or through a holding company. In addition, in many families, there is the continuing concern for ownership and management, governance, structure, and organization. In many family entities, there is a lack of separation of ownership from management. The lack of a proper governance framework that quite often negatively affects the ability of the organization to control its actions increases the likelihood of irregularities and results in inconsistencies in the way business is conducted.

Furthermore, in the Indian context, even where controlling shareholders or "promoters" do not own a majority of shares, they are believed to commonly exercise controlling rights in excess of their economic interests through cross holdings, pyramid structures, and other similar devices (Verma 1997; Bertrand, Mehta and Mullainathan 2002; Chakrabarti 2005; Varottil 2009; Afsharipour 2010). There is also extensive anecdotal evidence to substantiate expropriation by controlling shareholders in Indian companies. For instance, the scandal involving Satyam became public when, in December 2008, institutional investors noticed that Satyam tried to acquire two related companies offering large valuations for both companies with completely unrelated businesses (Afsharipour 2010). Often we hear of reports of expropriation of minority shareholders by majority shareholders in India. Thus, we can see that the "core" Indian CG problem relates to the second agency problem, i.e., the agency problem between noncontrolling shareholders (as principals) and controlling shareholders (as agents), rather than the one between controlling shareholders and management, as is the case in the Anglo-American world.

In analogous words, Varma (1997) has argued that the CG problems in India are dissimilar from those found in the Anglo-Saxon world and would need a different model of corporate governance, which has a noteworthy external focus. The governance issue in the United States or the United Kingdom is essentially that of disciplining the management that has ceased to be effectively accountable to the owners. As against this, the problem in the Indian CG is that of disciplining the dominant shareholder, who is the principle block-holder and of protecting the minority shareholders. According to Varma (1997), in the Indian context, it is not possible to resolve the conflict between the dominant shareholder and minority shareholders. In the backdrop of the key role played by the dominant shareholder or the promoter, in the Indian context, Varottil (2010), makes the case that the source for strengthening Indian CG lies within and the emulation of other systems of CG or even adopting best practices that may have been successful elsewhere would only lead to further incongruity with the traditional business systems and practices that are prevalent in India. Given that almost two-thirds of the top 500 Indian companies are group affiliated, issues relating to CG in business groups are naturally very important. Tunneling, or "the transfer of assets and profits out of firms for the benefit of those who control them," is a major concern in business groups with pyramidal ownership structure and interfirm cash flows.

Chakrabarti, Megginson, and Yadav (2008) drew on data from Prowess, a database maintained by the Centre for Monitoring the Indian Economy (CMIE), to analyze ownership patterns among India's 500 largest companies, comprising about 65 percent of the total Mumbai Stock Exchange (BSE) market capitalization. According to their analysis, 60 percent of these companies accounting for about 65 percent of the total market value were affiliated with family business groups, while another 11 percent, accounting for about 22 percent of total market capitalization, were wholly or significantly owned by the central government or state governments. Thus, their study indicates not just that shareholdings in major Indian companies are concentrated, but also that state and business groups continue to dominate their ownership. Red tape and regulations are among the leading deterrents for business and foreign investment in India. The same study has traced the evolution of the Indian CG system and examined how this system has both propped up and held back India's ascent to the top ranks of the world's economies. The authors of the study have found that, theoretically, while the framework of the country's legal system provides some of the finest shareholder protection in the world, enforcement is the foremost difficulty in view of the sluggish performance of the overburdened courts and the extensive pervasiveness of corruption.

When we enlarge the scope of review however, we find that, notwithstanding Clause 49, there are still many instances of controlling shareholder opportunism. It has been argued, separately, that the anecdotal evidence on CG reforms in India is less promising than the quantitative empirical evidence (Varottil 2009) and that paper protection does not translate into actual protection (Chakrabarti, Megginson and Yadav 2008). Jayati Sarkar and Sarkar illustrate that corporate boards of large companies in India in 2003 were slightly smaller than those in the United States (in 1991), with 9.46 members on average in India compared to 11.45 in America. Shareholding patterns in India reveal a marked level of concentration in the hands of the promoters. In 2002–2003, for instance, Sarkar and Sankar found that promoters held 47.74 percent of the shares in a sample of almost 2,500 listed manufacturing companies, and held 50.78 percent of the shares of group companies and 45.94 percent of stand-alone firms. In another study based on 2001 data that distinguishes between "controlling" insiders and "noncontrolling groups," Selarka (2005) reports a U-shaped relationship between insider ownership (with insiders being defined as promoters and "persons acting in concert with promoters") and firm value, with the point of inflection lying at a much higher level, between 45 and 63 percent. Three papers study CG in India and carefully trace through pyramidal shareholding structures to identify a firm's ultimate owners. Khann and Palepu (2000) and Sarkar and Sarkar (1998) examine how the identity of the immediate owners of Indian firms is correlated with the firms' valuation, as measured by a market-to-book ratio. Chhibber and Majumdar (1999) examine how ownership characteristics of Indian firms affect profitability. A common result across the three Indian papers is that high foreign ownership has beneficial effects (either on market valuation or profitability). They conclude that the main CG problem in these countries is the expropriation of minority shareholders by controlling shareholders. Lins (2000) relates ownership structure to firm value across 22 emerging markets. Claessens and Djankov (1999a, 1999b) study CG in transition economies. Using data on recently privatized firms, they find that firms with concentrated ownership, foreign ownership, and ownership by nonbank investment funds are more profitable and have higher labor productivity.

In a study that used only balance sheet information from four selected sectors of the Indian industry, Mukherjee and Ghosh (2004) analyzed the efficacy of CG. Their findings, by and large, painted a disappointing picture with the overall conclusion that CG was still in a very nascent stage in the Indian industry. The author found that decision and policy making was still taken mostly as an outline matter, and among the institutional investors also, it seemed that the foreign institutional investors were the most consistent in stock picking, whereas the performance of domestic institutional investors was sporadic and volatile, at best. They also found grave shortcomings in the capital market in not being able to enforce better governance on the part of the directors or performance on the part of managers.

Executive compensation in India, which was freed from the strict regulation by the Companies Act in 1994, is an additional area of CG that has received interest among researchers. A study conducted by Ghosh (2006) in the research paper "Determination of Executive Compensation in an Emerging Economy: Evidence from India" used the panel data of 462 firms from 1997 to 2002 of Indian manufacturing sector found that, during 1997–2002, the average (of a sample of 462 manufacturing firms) board compensation in India has been around Rs. 5.3 million (approximately USD 120,000), with wide variation across firm size. The average board compensation is Rs. 7.6 million (USD 171,000) for large firms and Rs. 2.5 million (USD 56,000) for small firms. The board compensation also appears to be higher, on average, at Rs. 6.9 million (USD 155,500) if the CEO is related to the founding family. Both board and CEO compensation depend on current performance, and CEO pay depends on past-year performance as well. Diversified companies also pay their boards more (Ghosh 2006).

Transparency and the quality of CG standards are very intimately correlated. Cross-country studies have repetitively put India among the worst nations in terms of earnings opacity and management. Indian accounting standards provide considerable flexibility to firms in their financial reporting and differ from the International Accounting Standards (IAS) in several ways that often make interpreting Indian financial statements a challenging task. These deviations, nevertheless, need to be viewed correctly. Armour and Lele (2009) found substantial support for political theories to explicate existing structures in India and found that dominant networks and high concentration of wealth of leading business families helps them to operate as an effective interest group in seeking regulatory reform and that the needs of businesses as opposed to investors and employees appear to be heard most vociferously by those conscientious for reform.

The Indian judicial system endures weak spots on all these fronts (Chakrabarti, Megginson and Yadav 2008; Afsharipour 2009; Armour and Lele 2009; World Bank/ IFC 2011). The political view thus advocate that it may well be in the interests of the incumbents not to restructure or invigorate what are frequently termed as "defendants' courts" in India. India is recognized to suffer from a relentless dearth of skilled judges, and there are multitude of cases pending before its Supreme Court, High Courts, and its local courts (Armour and Lele 2009). The reality is that the Indian judicial system, at best, is characterized by delays and, at worst, is dysfunctionality and corruption. La Porta, Lopes-de-Silanes, Shleifer and Vishny (1998) in the survey of CG show that in countries where the legal system does not do a good job of protecting shareholders' rights, concentrated ownership is more prevalent.

However, Chakrabarti Megginson and Yadav (2008) have also found that CG in India does not compare unfavorably with that in any of the other major emerging economies of the world, viz Brazil, China, and Russia. Two influential empirical studies have evaluated the effectiveness of Clause 49 in addressing CG in India. Black and Khanna (2007) report a positive investor reaction to the introduction of Clause 49 and thus argue that "properly designed CG mechanisms have a positive impact on firm value." Dharmapala and Khanna (2008) empirically demonstrate that the introduction of sanctions related to the implementation of Clause 49 has a constructive impact of firm value, of a magnitude higher than that in the 2007 study. Hence, both studies designate that the measures introduced through Clause 49 have had an encouraging impact on CG in India. Thus, although there is substantiation that the introduction of Clause 49 has resulted in better CG, there is still a lengthy road ahead. For instance, while the World Bank ranks India 44th among 183 countries under the category of "Investor Protection" (based on an "antiself-dealing index" developed by Djankov et al. (2008) to measure the extent of legal protection of minority shareholders), the same report ranks India 182nd in the "enforcement of contracts," which perhaps indicates better the extent to which legal rights are actually enforced in the country (World Bank 2011).

Multiple directorships by independent directors seem to correlate positively with firm value, but multiple directorships by inside directors are, however, negatively related to firm performance (Sarkar and Sarkar 2009). The researchers have argued that the Indian CG system is capable of inspiring confidence among institutional and, increasingly, foreign investors and has a legal system that provides some of the best investor protection in the world. The problem, however, has been the lack of enforcement (Rajagopal and Zhang 2008). Concentrated ownership and family business groups are the dominant business model, with evidence of tunneling activity that transfers cash flow and value from minority to controlling shareholders as mentioned earlier (Bertrand and Mullianthan 2002). The nature of CG can affect the capital structure of a company. In the presence of well-functioning FIs, debt can be a disciplining mechanism in the hands of shareholders or an expropriating mechanism in the hands of controlling insiders. Studying the relationship between leverage and Tobin's Q in 1996, 2000, and 2003, Sarkar and Sarkar concluded that the disciplinary effect has been more marked in recent years as institutions have adopted greater market orientations (Srinivasan, Padmini and Srinivasan, Vasanthi 2011).

Institutional Journey of Corporate Governance through the Regulatory Maze and Its Slip-ups

The extraordinary economic development has changed the nature and character of the world economy including the foreign investment flows (Khanna and Palepu 2006). The growth of India's GDP has averaged about 6 percent since 1991 and attained around 8 percent till the economic recession slowed down the world economies. Still India, along with China, is one of the fastest growing countries in the world. The requirements of India's growing economy, including access to FDI, the increased presence of institutional investors (both domestic and foreign) in India, and the rising aspiration of Indian companies to access global capital markets by gaining listing on stock exchanges outside of India have stimulated economic and CG reforms. More crucially, big corporations in India have been instrumental in leading the course toward prescribed CG changes in India. Foreign investments in India have come directly and through secondary markets in recent years especially postreforms. The cumulative foreign direct investment (FDI) to India until August 2010 was US $137,960 million (RBI Bulletin 2010). There has also been a noteworthy increase in cross-border acquisitions and a number of firms list their shares in multiple exchanges (Fulghieri 2006; Bell, Moore, and Al-Shammari 2008). Foreign institutional investors have made substantial investments in the capital market, for instance, an amount $4.78 billion in the Indian capital market in November 2010 alone and a total investment of $38 billion until March 2011.

Investors from developed countries are also insisting that Indian Companies pursue international best practices and regulations with an emphasis on transparent and accountable CG. The scandals related to the Indian markets (Goswami 2002), the global financial crisis of 2008, and the more recent corporate fraud at Satyam have been lumped together to increase a lot of apprehension about governance practices in India. Accordingly, India's rank on transparency international's corruption perception index (CPI) has also declined further to 95 out of 183 countries surveyed this year, from 87 out of 178 countries in 2010, indicating a serious corruption problem. These figures have only worsened recently with unraveling of the 2G spectrum scam and coal allocation scam. Scores from 3 to 5 indicate that corruption is perceived to be a "serious challenge," while scores below 3 indicates "rampant corruption."

Red tape and regulations remain among the main deterrents for business and foreign investment in India, leading to its latest ranking of 120 out of 178. In the World Bank's Doing Business 2008 publication, India is ranked 111th out of 178 for the ease of starting a business, worse than Russia (ranked 50) but better than Brazil (ranked 122) and China (ranked 135). Delays and the costs of dealing with licenses in India are also far worse than the global average, with India ranked 134th out of

178. Similarly according to the report "The Drivers and Dynamics of Illicit Financial Flows from India: 1948–2008," released by Washington-based, Global Financial Integrity. Postindependence, India lost a staggering USD 462 billion in illicit financial flows due to tax evasion, crime, and corruption. The report also stated that some 68 percent of India's aggregate illicit capital loss occurred after India's economic reforms in 1991, indicating that deregulation and trade liberalization actually contributed to or accelerated the transfer of illicit money abroad. There continues to be a decline in India's integrity score to 3.1 in 2011 from 3.5 in 2007, 3.4 in 2008–2009, and 3.3 in 2010. Subsequently, there has been a mounting challenge and demands around CG structures and instruments by both regulators and corporations. Since it is well recognized that the institutional context of an economy, i.e., the combination of formal rules, informal constraints, and the enforcement characteristics varies significantly across countries and has an influence on corporate financial and governance structures (Walsh and Seward 1990; North, 1990), understanding the state of CG research in the Indian context is, therefore, of immense academic interest and business significance (Srinivasan and Srinivasan, 2011).

It must be pointed out here that capital markets are not recent to India. From 1866 onward, there were several pieces of legislation governing CG, trust activity, banking activity, and securities regulation (Goswami 2003). The BSE was established in 1875 and is the oldest stock exchange in Asia. At the beginning of the 20th century, India had four functioning stock exchanges with well-defined rules governing listing, trading, and settlement rules and by 1947 over 800 companies were listed and trading on Indian exchanges. Following India's independence in 1947, new businesses were often promoted by leading managing agencies, with promoters contributing a minimal amount of equity capital and then raising the balance either through public offerings or from public development finance institutions (DFIs) established by the state to facilitate the allocation of industrial credit (or, sometimes, through investment institutions).

The vehicle for corporate growth was the "managing agency." It worked something like this: every major corporate group had a closely held company or partnership called a managing agency. In effect, these functioned like holding companies. Managing agencies would float companies, and their *imprimatur* sufficed to ensure massive oversubscription of shares. Given excess demand, most of these companies could split shareholdings into small enough allotments to ensure that nobody—barring the managing agency—had sufficiently large stocks to ensure their presence on the BOD. Thus, dispersed ownership allowed managing agencies to retain corporate control with relatively low equity ownership—a trend that continued right up to the mid-1980s and early 1990s. From the CG point of view, therefore, the tendency for management in India to enjoy control rights that are disproportionately greater than its residual cash flow rights goes back to the early years of the 20th century (Goswami 2003).

Postindependence and prior to economic liberalization, India's capital markets remained largely undersized. Following independence, the Indian government put in place a number of policies that had the effect of causing the waning of CG in India. This happened with a sequence of industrial policy resolutions, which entrusted the state with a much larger dependability for managing the economy. Early corporate developments in India were marked by the managing agency system. This not only contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The move toward socialism in the decades after independence, marked by the 1951 Industries (Development and Regulation) Act and the 1956 Industrial Policy Resolution, put in place a regime and a culture of licensing, protection popularly known as license permit Raj (rule) and widespread red tape that bred corruption and stilted the growth of the corporate sector. The condition deteriorated in subsequent decades and corruption, nepotism, and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant tax rates encouraged creative accounting practices and gave firms incentives to develop complicated emolument structures with large "under-the-table" compensation at senior levels.

The changes bent by these resolutions incorporated a much-expanded state-owned sector. The government was to become the sole provider of many goods and services, which led to the nationalization of certain industries (in particular, FIs) and the exclusion of private firms and competition from large sectors of the economy. Furthermore, Indian state-owned enterprises (SOEs) were not merely being run to capitalize on profits, but for a multiplicity of supplementary reasons as well (Goswami 2003). In light of this, it is unsurprising that firms would not focus their CG on efficiency. This was accompanied by a succession of enactments that worked as entrance barriers to some markets and to investment. This insulated domestic firms from foreign competition and, when combined with the extensive licensing requirements, insulated domestic firms from much further domestic competition. The lack of competition benefited incumbents, but hindered further growth in CG by reducing the competitive demands to be professional or accountable. The primary source of capital for many Indian firms was debt capital. This was made available by the State through a variety of state-owned and -operated DFIs (World Bank Report 2005; Chakrabarti 2005; Goswami 2003). Consequently, after 1991 the Indian corporate landscape changed drastically from its preindependence and early decades of independence situation. However, the term "corporate governance" remained unidentified and unheard of until 1993. It came to the fore because of a spate of corporate scandals that occurred during the first flush of economic liberalization.

Although financial disclosure norms in India have traditionally been better than most Asian countries, noncompliance with disclosure norms had been rampant and even the failure of auditors' reports to conform to the law attracted only nominal fines and little punitive action (Chakrabarti, Megginson, Yadav 2007). While the Companies Act 1956 provided an exceptional structure, and clear instructions for maintaining and updating share registers, in reality minority shareholders suffered from irregularities in share transfers and registrations. Promoters sometimes sought to channel funds and to enable the expropriation of minority shareholders through the use of nonvoting, preferential shares. There were cases in which the rights of minority shareholders had been compromised by management's private deals in the relatively infrequent event of corporate takeovers. Company boards were often largely ineffective in their monitoring role, and their independence was perceived as highly questionable.

Since liberalization, Indian corporate history has had a complicated history, with three major scandals erupting. The first and foremost major securities scam uncovered was in April 1992. This involved a large number of banks, and resulted in the stock market nose-diving for the first time but, even more significantly, it occurred within a year of the advent of reforms in 1991. The second was an abrupt growth of cases where MNCs started consolidating their ownership by issuing preferential equity allotments to their controlling group at steep discounts compared to their market price (Goswami 1996). The third scandal involved disappearing companies during 1993–1994. Between July 1993 and September 1994, the stock index shot up by 120 percent. During this boom, hundreds of obscure companies made public issues at large share premiums, buttressed by sales pitches of obscure investment banks and misleading prospectuses. The management of most of these companies siphoned off the funds, and a vast number of small investors were saddled with illiquid stocks of dud companies. This shattered investor confidence resulted in the virtual annihilation of the primary market for the next six years (Goswami 2003).

Among the other corporate and capital market scams, there was the Ketan Parekh heist in 2002 (along the lines of a similar fraud perpetrated by Harshad Mehta a decade earlier) where the Bank of India, Madhavpura Cooperative Bank, and others lost billions of rupees, and the insider trading scam involving the Monthly Income Plan investments in Unit Trust of India where scores of large business houses were able to foreclose their investments while millions of small unit holders were left to bear the losses. Others include the phenomenon of companies on the stock exchanges disappearing after their public offers for subscription, the notorious Z list of companies of dubious credentials on the BSE, and so on. Much of the fraudulent and often irresponsible behavior of the fraudsters was facilitated by lax controls and monitoring systems within the companies as well as in the operation of the regulatory systems. These episodes led to the prominence of the concept of CG among the financial press, banks and FIs, mutual funds, shareholders, some more enlightened business associations, regulatory agencies, and the government.

Today, growing numbers of listed companies have begun to identify the requirement for transparency, ethical business, and good governance. A rising number of chief executive officers currently recognize that complex cross-holdings, opaque financial disclosures, rubber-stamp boards, and inadequate concern for minority shareholders are a recipe for being shut out of competitive capital markets. After all the widely known Enron example shows that failed governance was largely due to a lack of ethics rather than a lack of regulations, thus illustrating an "excellent example of board passivity" (Downes and Russ 2005). Thus, almost two decades after the start of economic liberalization, the consolidation of desirable CG practices could be discerned, and indicators suggest that the movement will strengthen further as pressures mount from all quarters.

Large Indian firms and industry groups campaigned for CG standards that mirrored standards in more developed countries to be embraced in order to obtain access to FDI, institutional investors (both domestic and foreign), and global capital markets. Beginning in the late 1990s, industry group such as the Confederation of Indian Industry (CII) advocated for wide-ranging CG standards. In 1996, the CII formed a task force to develop a CG code for Indian companies. Desirable Corporate Governance: A Code (CII Code) for listed companies was proposed by the CII in April 1998. The CII Code contained comprehensive governance provisions related to listed companies, even though it was voluntarily adopted by only a few companies and did not result in a broad overhaul of governance norms and practices by Indian companies. According to Birla Committee Report 1999, the Indian companies, banks, and FIs can no longer afford to discount improved corporate practices. Soon after introduction of the CII Code, SEBI appointed the committee on CG (Birla Committee 1999).

In 1999, the Birla Committee put forward a report to SEBI "to promote and raise the standard of Corporate Governance" for listed companies. Significantly the Birla Committee singled out the CG reports and codes being applied in the United States and United Kingdom, such as the report of the Cadbury Committee, the Combined Code of London Stock Exchange, and the Blue Ribbon Committee on Corporate Governance in the United States. The committee even directly sought out the input of Sir Adrian Cadbury, chair of the Cadbury Committee, commissioned by the London Stock Exchange, in addition to Indian business leaders. In its final report, the Birla Committee noted its dual reliance on international experiences—both as an impetus for reform following "high profile financial failure even among firms in the developed economies and as a model for reform" (Birla Committee 1999).

The Birla Committee distinctively placed stress on independent directors in discussing board recommendations and made specific recommendations regarding board representation and independence. The committee also recognized the importance of the audit committee and made many detailed recommendations regarding the function and constitution of board audit committees. In early 2000, the SEBI board acknowledged and authorized the key recommendations of the Birla Committee, which were consequently included into Clause 49 of the listing agreements of the stock exchange. Clause 49 essentially refers to a clause in the listing agreement required to be maintained by a public company in India with the stock exchange on which its securities are listed under Section 21 of the Securities (Contracts) Regulation Act, 1956. The format of the listing agreement is prescribed by SEBI (BSE), and is standard across all stock exchanges in India. SEBI implemented the Birla Committee's proposals less than five months later, in February 2000. At that time, SEBI revised its Listing Agreement to incorporate the recommendations of the country's new code on CG. These rules contained in Clause 49, a new section of the Listing Agreement took effect in phases between 2000 and 2003. The reforms applied earliest to newly listed and large companies, then to smaller companies, and ultimately to the vast majority of listed companies. Dr. P.L. Sanjeev Reddy, secretary, DCA, stated that the aim was to operationalize the concept of corporate excellence on a persistent basis, so as to sharpen India's global competitive edge and to further develop corporate culture in the country.

The subsequent initiative on CG in India was in the form of the recommendations of the Narayana Murthy Committee. This committee was set up by SEBI under the chairmanship of Mr. N.R. Narayana Murthy, in order to review Clause 49 and to suggest measures to improve CG standards. The Murthy Committee, like the Birla Committee, pointed out that international development constituted a factor that motivated reform and highlighted the need for additional restructuring in view of the latest failures of CG, predominantly in the United States, combined with the annotations of India's stock exchanges that acquiescence with Clause 49 had up to that point been irregular. While the report of the Murthy Committee did not explicitly cite the Anglo- American models of governance, it was unmistakably a response to measures in the United States, which followed just a few months after the improvement of the Sarbanes-Oxley Act (SOA). There are remarkable comparisons between

Clause 49 and the leading Anglo-American CG standards, in particular, the Cadbury Report, the OECD Principles of Corporate Governance, and SOA. The key mandatory features of Clause 49 regulations deal with the following: (1) composition of the BOD; (2) the composition and functioning of the audit committee; (3) governance and disclosures regarding subsidiary companies; (4) disclosures by the company; (5) CEO/CFO certification of financial results; (6) reporting on CG as part of the annual report; and (7) certification of compliance of a company with the provisions of Clause 49. In the compliance report, noncompliance if any of the mandatory requirements under Clause 49 is required to be reported and explained, while the adoption of any nonmandatory requirements is to be highlighted.

India's CG reform efforts did not cease after the adoption of Clause 49. In parallel, the review and redrafting of the Companies Act 1956 (which was amended as many as 24 times) was taken up by the MCA on the basis of a detailed suggestion constituted an Expert Committee on Company Law under the Chairmanship of J.J. Irani on December 2, 2004 to offer advice on the new Companies Bill. The Irani Committee acknowledged that requirements of special or small companies be accounted for through a series of exemptions, so that smaller businesses would not be weighed down with the equivalent level of compliance costs as bigger, established corporations. The Committee's objective was to enlarge the arrangement of classifications and exemptions to tailor compliance costs to needs, while upholding ample regulatory stringency for large listed companies that access public capital. Based, among other things, on the recommendations of the Irani Committee, the proposed Companies Bill, 2009, sought to facilitate the corporate sector in India to operate in a regulatory environment characterized by finest international practices that fosters entrepreneurship and investment.

The most recent attempt to revise the 1956 Act was the Companies Bill, 2009, which was introduced in the Lok Sabha (one of the two houses of parliament of India) on August 3, 2009. Subsequently, the Bill was considered and approved by the Lok Sabha on December 18, 2012 as the Companies Bill, 2012. The Bill was then considered and approved by the Rajya Sabha too on August 8, 2013. It received the president's assent on August 29, 2013 and has now become the Companies Act, 2013. The changes in the 2013 Act have across-the-board propositions that are set to extensively change the manner in which corporates operate in India. In the 2013 Act, there is noteworthy focus on corporate reporting framework, both internal and external and an extensive range of changes have been initiated keeping in mind objectives, such as the need for relevance and consistency in the financial information being reported ,alignment with international practices, greater focus on internal controls, and so on. Some of the requirements have also been pioneered to attend to lacunae in several of the provisions under the 1956 Act and curb any associated abuse.

Overhauling of Indian Corporate Law—A Response to Corporate Malfeasance and Need to Plug in Institutional Slither

While the country's record of ratifying legislative and regulatory progress has been in sync with international standards, there have also been numerous occurrences of corporate misdemeanors during this decade. At the top of the list was the major fraud at Satyam Computers, the fourth largest Indian software services company (after TCS, Infosys, and Wipro). This fraud was perpetrated over a seven to eight year period during the decade by the CEO, who had until his confession in January 2009 enjoyed a very high personal reputation for integrity and model behavior. This happening also exposed an atypical display of institutional investor activism and resistance, where dubious corporate decisions that were seen as patently enriching those in operational control at the expense of other shareholders were disapproved. Regrettably, this disaster also surfaced the board's perceived independence and oversight diligence in the most adverse light, especially since the company's star-studded board satisfied the most desirable prerequisites of ideal composition and structure. Another foremost casualty in this episode was the institution of independent audit, and the reputational credibility of even internationally distinguished audit firms. While damage control procedures did undeniably salvage the company and the image of the country, thanks to some exemplary proposals by the government and the industry itself, the scars of this mega scam will almost certainly take a long time to fade away.

The Satyam scandal also served as a catalyst for the Indian government to rethink the CG, disclosure, accountability, risk management, and enforcement mechanisms in place. For corporate leaders, regulators and politicians in India, as well as for foreign investors, this necessitated a reassessment of the country's progress in CG. As a outcome of this scam, India's ranking in the CLSA Corporate Governance Watch 2010 slid from third to seventh within Asia. Industry reaction soon after news of the scandal broke was that the CII initiated examining the CG issues arising out of the Satyam scandal. Other industry groups also formed CG and ethics committees to study the impact and lessons of the scandal. In late 2009, a CII task force put forth CG reform recommendations. In addition to the CII, the National Association of Software and Services Companies (NASSCOM) also formed a Corporate Governance and Ethics Committee, chaired by N. R. Narayana Murthy, one of the founders of Infosys and a leading figure in Indian CG reforms. The Committee issued its recommendations in mid-2010, focusing on "stakeholders" in the company. The report underlines recommendations related to the audit committee and a whistleblower policy. The report in addition addresses improving shareholder rights. The Institute of Company Secretaries of India (ICSI) has also put forth a series of CG recommendations. Given that the Satyam scandal involved a foiled related-party transaction, the Corporate Governance Guidelines also make some inroads into addressing related-party transactions. The guidelines require that the audit committee of the BOD (1) should monitor and approve all related-party transactions, and (2) should provide public disclosure about all related-party transactions that take place in a particular year. Generally large, exceedingly visible, and publicized corporate scandals provoked legislative and regulatory measures. It needs to be acknowledged that while the superstructure of CG is built on laws and regulations, these cannot be anything more than a basic framework. Much of best-in class CG is voluntary, of companies taking conscious decisions of going beyond the mere letter of law.

By government and industry reaction, Satyam impelled swift action by both SEBI and the MCA. In September 2009, the SEBI Committee on Disclosure and Accounting Standards issued a discussion paper that considered proposals for the following:

- appointment of the chief financial officer (CFO) by the audit committee after assessing the qualifications, experience, and background of the candidate;
- rotation of audit partners every five years;
- voluntary adoption of international financial reporting standards (IFRS);
- interim disclosure of balance sheets (audited figures of major heads) on a half-yearly basis; and
- streamlining of timelines for submission of various financial statements by listed entities as required under the Listing Agreement.

In early 2010, SEBI amended the Listing Agreement to add provisions related to the appointment of the CFO by the audit committee and other matters related to financial disclosures. However, other proposals such as rotation of audit partners were not included in the amendment of the Listing Agreement. MCA actions inspired by industry recommendations, including the influential CII recommendations, in late 2009 the MCA released a set of voluntary guidelines for CG. The Voluntary Guidelines address a myriad of CG matters including the following:

- independence of the BOD;
- responsibilities of the board, the audit committee, auditors, secretarial audits; and
- mechanisms to encourage and protect whistleblowing.

In discussing the voluntary nature of the guidelines, the MCA pointed toward the guidelines are a foremost step and that the option remains open to possibly progress to somewhat more mandatory. Then the Indian Parliament has passed the historic Companies Bill, 2013. The new Companies Bill proposes structural and deep-seated changes in the way companies would be governed in India and incorporates various lessons that have been learned from the corporate scams and malfeasance of the recent years that highlighted the role and importance of good governance in organizations.

The Bill allows the country to have a modern legislation for regulation of corporate sector in India. The Bill, among other aspects, provides for business responsive corporate regulation/pro-business initiatives, e-governance initiatives, good CG, Corporate Social Responsibility (CSR), enhanced disclosure norms, and better accountability of management, stricter enforcement, audit accountability, protection for minority shareholders, investor protection and activism, and superior framework for insolvency regulation and institutional structure. The intent behind the 2013 Act is lesser government approvals and enhanced self-regulations coupled with stress on corporate democracy. The 2013 Act delinks the procedural aspects from the substantive law and provides greater flexibility in rulemaking to enable adaptation to the changing economic and technical environment.

Companies Act 2013, CSR, and Sustainability—Shift from "Zone of Voluntarism" to Mandatory CSR

As India continues to develop, it has tough options to make on how to accomplish its twin objectives of sustainable development and inclusive growth. India needs to espouse policies to focus on clean and efficient technologies and practices to meet these objectives. By 2030, India is likely to have a GDP of USD 4 trillion and a population of 1.5 billion. This will swell demand for critical resources such as coal and oil with a parallel increase in green house gas (GHG) emissions. Considering that 80 percent of the India of 2030 is yet to be built, the country may have an exceptional opportunity and challenge to pursue development while managing emissions growth, enhancing its energy security, and creating a few world-scale clean-technology industries. This would require that India leapfrog inefficient technologies, assets, and practices and deploy ones that are efficient and less emission intensive. To accomplish this will necessitate funding an incremental investment amounting to 1.8–2.3 percent of GDP between 2010 and 2030. A 2008 report suggests that India has the world's third biggest ecological footprint, that its resource use is already twice that of its bio-capacity, and that this bio-capacity itself has declined by half in the last few decades (GFN and CII 2008). Projections based on the historic trend of materials and energy use in India also point to serious levels of domestic and global impact on the environment if India continues on its contemporary development trajectory modeled on industrialized countries (Singh et al. 2012).

With the passage of the Companies Act, 2013 the mandate for CSR has been officially initiated to the dashboard of the Indian companies' boards. The insertion of the CSR mandate under the Companies Act, 2013 is an endeavor to supplement the government's efforts at equitably delivering the benefits of growth and to engage the corporate world with the country's development agenda. Terms like "ecosystems services," "shared value creation," and "cradle-to-cradle products," once relegated to academics or sustainability advocates, are now part of daily discourse. Sustainable originally meant "capable of being borne or endured," but in more recent times it became "capable of being upheld or defended." Environmentalists clearly drive toward the former view while business tends toward the second, and governments vacillate between the two. How those terms are used, and whether they are applied consistently within and among organizations, is another matter. But the fact that these terms are talked about gestures progress and signifies a fuller understanding and appreciation of sustainability's growing value inside companies. The sustainability survey conducted by KPMG on six key trends in sustainability (2013) reconfirms that companies' response and approach to sustainability issues are influenced significantly by the "tone from the top," that is, how and how much senior management are engaged in the conversation and how they engage with it. "As the sustainability conversation in some companies' shifts from eco-efficiency to risk reduction and mitigation of natural resource shortages, extreme weather events and supply-chain disruptions sustainability is being seen as affecting a company's ability to compete" (KPMG 2013). This reflects the realization that environmental, societal, and market shifts will increasingly roil everything from commodity prices to natural resource shortages to disease epidemics—all of which can affect business continuity, the right to operate, and reputation. The complexity of corporate sustainability issues has led companies to appreciate that sustainability needs to be more firmly integrated throughout the organization: in finance, operations, procurement, facilities, human resources, supply chain, logistics, finance investor relations, marketing and communications, and more. True CG and responsibility can only grow from an integrated system that links executive authority, financial accounting, board accountability, and stakeholder aspirations to transparency, which entails a code of principles that is rigorously applied in practice. This offers a challenge when one also has to acknowledge that the playing field globally is far from level. Developing this evenhanded perspective and sound governance approaches are a critical part of developing sustainability but many business leaders are as an outcome finding themselves bounded by pressures from a wide range of stakeholders and mounting regulations.

The last decades of the 20th century has also seen a swing away from charity and traditional philanthropy toward more direct engagement of business in mainstream development in India. Most corporate houses have been contributing to social causes mainly through their own trusts, foundations, and societies. Some of these were set up long before India achieved independence. Today there are over 200,000 private sector trusts in India, a large number of which have been set up by business (Gupta 2014). "This has been driven both internally by corporate will and externally by increased governmental and public expectations" (Mohan 2001). Organizations like Amul Milk Cooperative, Sewa India, and Shri Mahila Griha Udyog have illustrated business success with decentralization of management and with a focus toward empowerment and participation of the poor. Indian Companies like Infosys Ltd. have set up Infosys Foundation to help older people, the destitute, handicapped, deserving students, and budding artists, as well as promoting medical care for children, women, and senior citizens suffering from cancer or brain fever. It has donated surgical equipment and ultrasound scanners to several hospitals in Karnataka. Tata Steel has adopted the Corporate Citizenship Index, Tata Business Excellence Model, and the Tata Index for Sustainable Development. Tata Steel spends 5–7 percent of its profit after tax on several CSR initiatives. Ranbaxy, an Indian MNC, 11th in the pharmaceutical sector, set up Ranbaxy rural development trust to provide basic health care to the underprivileged through mobile health care that reaches out the needy in villages and slums. Over 500 self-help groups are currently operating under various poverty alleviation programs; out of which over 200 are engaged in activities of income generation thorough microenterprises. The Mahindra group of companies encourages education of employee's children by running schools at plant sites. It also supports education for all at all levels by providing studentship, loans, and scholarships for research students studying overseas, rehabilitation of disabled children, distribution of free books to children in slum and rural areas, and the endowment of the chair for research in nuclear sciences and journalism (Mohan 2001). National Thermal Power Corporation (NTPC) believes in growth with a human face and pursuing people-centered development. NTPC is a socially committed organization and a socially responsible corporate citizen. Dr. Reddy's Laboratories in Hyderabad, Andhra Pradesh, is an emerging global pharmaceutical company focused on creating and delivering innovative health care solutions that enable people to lead healthier lives (Gupta 2014).

Several policy pronouncements of the Government of India, such as the National Environment Policy 2006 or the Approach Papers of various Five Year Plans, have promised the integration of development and environment. There is no set of indicators on sustainability in use by the Planning Commission or any other government body at the center or in the states. There is emphasis on reporting on sustainability by corporations and organizations, following up on the National Voluntary Guidelines on Social, Economic, and Environmental Responsibilities of Business by the MCA (accompanied by the Business Responsibility Reports mandated by the SEBI for the top 100 companies) using frameworks such as that of the Global Reporting Initiative. Several private or public sector companies are voluntarily reporting on their sustainability performance, using frameworks such as the Global Reporting Initiative's Sustainability Reporting Guidelines.

By virtue of these Guidelines being derived out of the unique challenges of the Indian economy and the Indian nation, they take cognizance of the fact that all agencies need to collaborate together, to ensure that businesses flourish, even as they contribute to the wholesome and inclusive development of the country. The Guidelines emphasize that responsible businesses alone will be able to help India meet its ambitious goal of inclusive and sustainable all round development, while becoming a powerful global economy by 2020. The Guidelines are designed to be used by all businesses irrespective of size, sector, or location and therefore touch on the fundamental aspects—the "spirit"—of an enterprise. It is expected that all businesses in India, including MNCs that operate in the country, would consciously work toward following the Guidelines. The Guidelines are applicable to all such entities, and are expected to be accepted by them comprehensively, as they elevate the bar in a manner that makes their value-creating operations sustainable. It needs to be highlighted that all principles are uniformly significant and nondivisible—this implies that if a business endeavors to function responsibly, it would have to assume each of the nine (9) principles in their entirety rather than picking and choosing what might suit them. It advocates businesses to embrace the "triple bottom-line" approach, whereby its financial performance can be synchronized with the expectations of society, the environment, and the many stakeholders it interfaces with in a sustainable manner.

To assist accomplishment, a segment has also been incorporated on developing management systems and processes for responsible business, and indicators that businesses can assume to self-steer and regulate their journey toward becoming sustainable and responsible businesses. The processes spotlight on changes in leadership and the leadership structure in the organization, the assimilation of the principle and core elements into the very business rationale of the organization, and ensuring that engagement with stakeholders happens on a consistent, continuous basis. Since these guidelines are germane to large and small businesses alike, a particular section has also been incorporated on how micro, small, and medium enterprises (MSMEs) can be encouraged to espouse the guidelines. Finally, a separate chapter on reporting has been integrated so that the business entities are not only able to take on the guidelines but also to spell out the implementation to their stakeholders through credible reporting and disclosures. The reporting framework is designed on the "apply-or-explain" principle, which is also an elemental basis of these guidelines. The recommended structure takes into account the necessities of the business entities that are already reporting in other recognized frameworks as well as those that yet do not have the capacity to undertake full reporting. Principle eight of the National Voluntary Guidelines on Social, Economic, and Environmental Responsibilities of Business relates to inclusive development and encompasses most of the aspects covered by the CSR clause of the Companies Act, 2013. However, the remaining eight principles relate to other aspects of the business. The U.N. Global Compact, an extensively used sustainability framework covering social, environmental, human rights, and governance issues, and what is described as CSR, is implicit rather than explicit in these principles (Table 3.1).

Table 3.1 Principles in the National Voluntary Guidelines on Social, Economic, and Environmental Responsibilities of Business (2009)

Principle 1: Businesses should conduct and govern themselves with Ethics1, transparency and accountability
Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle
Principle 3: Businesses should promote the well-being of all employees
Principle 4: Businesses should respect the interests of, and be responsive toward all stakeholders, especially those who are disadvantaged, vulnerable, and marginalized
Principle 5: Businesses should respect and promote human rights
Principle 6: Business should respect, protect, and make efforts to restore the environment
Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner
Principle 8: Businesses should support inclusive growth and equitable development
Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

Source: GoI; National Voluntary Guidelines on Social, Economic, and Environmental Responsibilities of Business 2009.

The company, in its endeavor to be conscientious, has to form an ethics subcommittee of the board that is empowered to examine all matters of alleged violation of ethical standards of the company, including decisions taken by its top management. This subcommittee uses a multiplicity of sources of information to determine the circumstances of ethics, transparency, and governance in the business. For illustration, the duly appointed ethics counselors of the company regularly intermingles with members of the subcommittee in formal, prescheduled meetings, and key senior executives are regularly encouraged for interactions. Vendors, randomly identified employees, Union officials, and other stakeholders of the business are encouraged to meet or write to the subcommittee. The ethics subcommittee in so doing provides the board with valuable feedback for constantly improving its governance systems. Furthermore, as a part of strengthening its ethical functioning, the company has also decided to separate the positions of chairman and that of managing director.

In the revised guidelines 2013, the thrust of CSR and sustainability is clearly on capacity building, empowerment of communities, inclusive socioeconomic growth, environment protection, promotion of green and energy-efficient technologies, development of backward regions, and improved life chances of the marginalized and underprivileged sections of the society. Making it mandatory in the revised guidelines for CPSEs to take up at least one major project for the development of a backward district has the potential of contributing significantly in the long run to socioeconomic growth in all the backward regions of the country. They are advised not to lose sight of their social responsibility and commitment to sustainable development even in their normal business activities. Rather, they are encouraged to use social responsibility and sustainability initiatives for business gains as well as social value creation through adoption of "shared value" approach, wherever achievable in their scheduled business operations. The reworked guidelines emphatically underscore the need for the top management of the public enterprises to be avidly involved in carrying ahead the schema of CSR and sustainability.

Some alterations have been made in the financial component of CSR and sustainability agenda. One, there is no separate allocation of budget for sustainable development, as was mandated earlier. Two, the slab of budgetary expenditure on CSR and sustainability activities for the CPSEs having PAT over Rs. 500 crore in the previous year would now be from 1 to 2 percent. Third, in the earlier guidelines there was a provision of a minimum expenditure of Rs. 3 crores on CSR activities for CPSEs having a net profit of Rs. 100–500 crores. This created an anomalous situation vis-à-vis the CPSEs placed in the higher slab, having a net profit of over Rs. 500 crore, for which no minimum expenditure was specified in the earlier guidelines. The requirement of a minimum expenditure of Rs. 3 crore has been removed in the revised guidelines. However, these CSR guidelines and especially the suggested slabs of budgetary allocation for CSR and sustainability activities would stand modified as and when the new company law brings in provisions in this regard, which would need to be followed by all companies including the CPSEs. According to Indian Institute of Corporate Affairs, a minimum of 6,000 Indian companies will be required to undertake CSR projects in order to comply with the provisions of the Companies Act, 2013, with many companies undertaking these initiatives for the first time. Furthermore, some estimates indicate that CSR commitments from companies can amount to as much as 20,000 crore INR.

The amalgamation of regulatory as well as societal pressure has meant that companies have to pursue their CSR activities more competently.

The Companies Act, 2013 has kicked off the idea of CSR to the forefront and through its disclose-or-explain mandate is endorsing greater transparency and disclosure. The Act lists out a set of activities entitled under CSR. Companies may put into operation these activities taking into account the neighboring conditions after seeking board authorization. The indicative activities, which can be embarked on by a company under CSR, have been specifically mentioned under Schedule VII of the Act. The Companies Act also states that only CSR activities carried out in India will be taken into consideration. Activities meant exclusively for employees and their families will not meet the criteria. A format for the board report on CSR has been provided that includes among others, activity-wise, reasons for spends under 2 percent of the average net profits of the previous three years and a responsibility statement that the CSR policy, implementation ,and monitoring process is in compliance with the CSR objectives, in letter and in spirit. This has to be signed by the CEO, the MD, or a director of the company. Clause 135 of the Act lays down the guidelines to be followed by companies while developing their CSR program. The CSR committee will be accountable for preparing a detailed plan on CSR activities, including the expenditure, the category of activities, roles and responsibilities of various stakeholders, and a monitoring mechanism for such activities. The CSR committee can also make certain that all the kinds of income accrued to the company by way of CSR activities should be credited back to the community or CSR corpus. The new Act requires that the board of the company shall, after taking into account the recommendations made by the CSR committee, consent the CSR policy for the company and divulge its contents in their report and also make public the information on the company's official website, if any, in such manner as may be prescribed. If the company falls short to spend the prescribed amount, the board, in its report, shall spell out the explanation.

Concluding Observations

CG reforms are critical to improving corporate performance and competitiveness, increasing market discipline and access to new sources of capital, and achieving higher levels of transparency and accountability. There is pervasive identification in India of its significance, and the governance reform process has been well under way for a number of years. What needs to be done to improve further CG is also broadly acknowledged. Numerous commissions and expert groups have considered the issues in-depth and offered recommendations for upgrading. The government under the demands from civil society has approved a number of antigraft laws such as the Lok Pal Bill and Whistleblowers bill. In addition to these measures, there has been stress to augment the autonomy of vigilance institutions like Central Vigilance Commission (CVC), Comptroller and Auditor General (CAG), Central Bureau of Investigation (CBI), and so on to facilitate an additional check on unbridled corruption in government, bureaucracy, and business. Indeed, much of the Companies Act 2013 draws from and reflects on the findings of these studies. In short, there is no absence of information: the policy and technical elucidation are known. With regard to evaluating eminence by benchmarking governance institutions in India with select international standards, the issues are rather complex.

The challenge going forward is instead one of implementation. What can be done differently to expand and deepen the ongoing reforms? How institutions can be made more responsible, thereby ensuring sustainable growth for the country. Experience shows that CG reforms are and should be seen as part and parcel of a broader reform program rather than as a stand-alone or substitute reform. Market discipline in turn puts pressure on companies to pursue sound business strategies and good governance. It also helps maximize and sustain the gains from improved governance. India's Companies Act is a step in the right direction as it mandates increased corporate transparency and accountability, which will bring reforms in the enforcement measures and endeavors to strengthen CG by making provisions to ensure more ethical and vigilant activities of directors and other professionals in the company. Law has also addressed the concerns caused by some of the scams like vanishing firms, the IPO imbroglio, and Satyam case and features and measures to prevent any such recurrence by bringing in a paradigm shift by enabling provisions for more stringent norms, disclosures, and increased penalties. Some of the provisions of the act are innovative like mandatory internal audit for specific companies, provision for rotation of auditors, increased role of the audit committee, restrictions on providing certain specified services by auditors, and restricting the financial year to April to March without any provision for extension, so placing more responsibilities and accountability on company management. More generally, for its long-term success, the emphasis continues to be on a need for India to develop and strengthen its institutions and structures of governance as without a strong enforcement environment the growth potential might just peter out. Matching rules on the ground with rules in the book is paramount to establishing the link between better governance systems and better economic outcomes.

Terms

1. The SEBI is the regulator charged with the orderly functioning of the securities market in India, protect the interests of investors, and ensure development of the securities market.
2. The MCA had also set up a National Foundation for Corporate Governance (NFCG) in association with the CII, ICAI, and ICSI as a not-for-profit trust to provide a platform to deliberate on issues relating to good CG, to sensitize corporate leaders on the importance of good CG practices as well as to facilitate exchange of experiences and ideas amongst corporate leaders, policy makers, regulators, law-enforcing agencies, and nongovernment organizations. The foundation has been set up with the mission to (1) foster a culture for promoting good governance, voluntary compliance, and facilitate effective participation of different stakeholders; (2) create a framework of best practices, structure, processes, and ethics; and (3) make significant difference to Indian corporate sector by raising the standard of CG in India toward achieving stability and growth.
3. Clause 49 of the Listing Agreements: The SEBI implemented the recommendations of the Birla Committee through the enactment of Clause 49 of the Listing Agreements. Clause 49 may well be viewed as a milestone in the evolution of CG practices in India. The terms were applied to companies in the BSE 200 and S&P C&X Nifty indices, and all newly listed companies, on March 31, 2001. These rules were applied to companies with a paid up capital of Rs. 10 crore or with a net worth of Rs. 25 crore at any time in the past five

years on March 31, 2002, and to other listed companies with a paid up capital of over Rs. 3 crore on March 31, 2003. The Narayana Murthy Committee worked on further refining the rules, and Clause 49 was amended in 2004.

4. *CII* has been a front-runner in the evolution of CG in India. From the Voluntary Code of Corporate Governance released as early as 1998 to the Report of the CII Task Force in 2009, CII established its position as a front-runner when, in a unique instance, an industry association took the lead in recommending CG practices for its member companies. CII's Code served as a base for various reports leading to Clause 49, as we know it today. CII also hosts the National Foundation for Corporate Governance, a public–private partnership initiative of the ministry with the three professional institutes—the Institute of Chartered Accountants of India, ICSI, and the Institute of Cost Accountants of India. CII has also been advocating industry's concerns on the regulatory front. It has been involved in each stage of development of the Companies Bill, finalization of the merger review process, and revision in the SEBI Takeover Code. It has represented industry's concerns and engaged in constructive dialog with the government and the regulator for the creation of a conducive regulatory environment for industry's growth. CII encourages voluntary adoption of best practices and self-regulation by corporates, thus obviating the need for warranting additional regulations. Its comprehensive and sustained policy advocacy is aimed at facilitating the creation of a streamlined and harmonized regulatory environment.
5. The National Voluntary Guidelines on Socioeconomic and Environmental Responsibilities of Business was brought out by the MCAs in 2009 to help the corporate sector in their efforts toward inclusive development and mainstreaming the concept of business responsibilities.
6. Satyam—labeled as "India's Enron" by the Indian media, the Satyam accounting fraud has comprehensively exposed the failure of the regulatory oversight mechanism in India. From being India's IT "crown jewel" and the country's "fourth largest" company with high-profile customers, the outsourcing firm Satyam Computers has become embroiled in

the nation's biggest corporate scam in living memory. Mr. Ramalinga Raju (chairman and founder of Satyam), who has been arrested and has confessed to a $1.47 billion (or Rs. 7,800 crore) fraud, admitted that he had made up profits for years. (Asia Times, 2009).

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Discussion Questions

1. Is there a need for global CG convergence and how would this help in benchmarking standards and cut into regulatory arbitrage?

2. In Indian case how do the dynamics of CG play out due to ownership structures and its relationships with performance in disciplining the dominant shareholder and protecting the minority shareholders?
3. Outline the historical, evolutionary perspective on the debate over the role of law and the state in CG. Explore some lessons for transition economies like India from the historical experience.
4. What are the key elements that come forward while tracing the evolutionary trajectory of CG framework in India?
5. Why has CG received more attention lately in developing countries like India?
6. India is a signatory to the Global Compact, yet there is little progress in promoting ethical business practices. How can India develop structures for facilitating adoption of CoE by Indian industry?
7. Assess the impact of New Companies Bill 2013 on CG in India. Discuss how effective will it be in plugging in the loopholes of the governance landscape?

CHAPTER 4

The Importance of Enterprise Technology Governance in Effective Corporate Governance

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Abstract

Although the term corporate governance was first propounded in the 1930s, the widespread usage of this term only came into vogue following the publication of the Cadbury Report in 1992 and has since been bandied about quite frequently in the business press. This chapter looks at some of the different definitions of corporate governance as well as the importance of corporate governance. It then looks at the core components that contribute to effective corporate governance by looking at the model developed by the Organization for Economic Cooperation and Development (OECD) Business Sector Advisory Group on Corporate Governance or more commonly known as the Millstein Report. Next, it goes on to discuss the importance of efforts to raise the awareness of

corporate governance globally, keeping in mind the differences in national cultures as well as differing social and economic priorities between sovereign nations. Finally, it looks at some of the key questions that boards ought to raise with their management in this digital era in order to be able to carry out their role as stewards effectively and thus enhance their practice of corporate governance. It then concludes by saying that at this point in time, a consensus on a single model of corporate governance is both unlikely and unnecessary as over time the exigencies of the capital market (market forces) will lead to increasing convergence in practice between countries.

Keywords: Corporate Governance, Cadbury Report, OECD, Millstein Report, Enterprise Technology Governance, Principles of Responsible Management Education (PRME) , ISO 38500.

Introduction

According to the former President of the World Bank:

> *"The governance of the corporation is now as important to the world economy as the government of countries" (Wolfensohn 1999, 38).*

This attests to the important position corporations have come to play in our economic and social lives as well as the global reach and political power of corporations, which often exceed the reach and power of governments. Furthermore according to Gregory and Simms (1999), the prevailing interest among policy makers for corporate governance reform as well as the related interest in reducing corruption and cronyism in business affairs is primarily grounded in economics and a belief in the distributive efficiency of free markets. With globalization and the removal of barriers to the free flow of capital, policy makers have come to recognize the importance of corporate governance in attracting capital inflows. Conversely weak corporate governance systems together with corruption and cronyism distort the efficient allocation of resources, thereby undermining the level playing field and ultimately hindering investment and economic development. The former chairman of the United States Federal Reserve Board Alan Greenspan in his remarks to the World Bank and International Monetary

Fund in 1999 touched on some of the lessons gleaned by policy makers in the aftermath of the Asian Economic Crisis, which started in July 1997. They included the systematic failure of investor protection mechanisms, weak capital market regulation as well as the existence of "crony capitalism." These, in turn, led to crises of confidence, which spread, from individual firms to entire nations. As noted by the renowned corporate governance expert Millstein (1998a), insufficient financial disclosure and capital market regulation, lack of minority shareholder protection, and failure of board and controlling shareholder accountability all supported lending and investing practices based on relationships rather than on a prudent analysis of risk and reward. Among others Harvey and Roper (1999) have observed how this state of affairs eventually led to overinvestment in nonproductive and speculative activities by corporations.

While more recent events, such as the Global Financial Crisis dating from 2008, make it clear that governance of corporations, whether by their own governing bodies or by the legislative jurisdictions under which they operate, is far from perfect, these same events have served to reinforce the need for effective corporate governance and to spur continuing effort to improve corporate governance.

In this chapter, we review the development of corporate governance and some of the key considerations underpinning these developments. We then focus our attention on an aspect of corporate governance that has been a topic of considerable debate in recent years—the aspect that deals with information technology.

The Definition of Corporate Governance

The providers of finance to corporations be it individuals, mutual/pension funds, banks, financial institutions, or even governments require assurances that their investments are both productive and protected. Increasingly, other stakeholder interests are also recognized, with assurance being sought that corporations exhibit appropriate behavior and stewardship of diverse resources, such as people and environment. Effective corporate governance should provide those assurances. Accordingly Millstein (1998a) defines the term corporate governance both narrowly as well as more broadly.

Millstein (1998a), in the narrower version of his definition, describes corporate governance as the relationship between managers, directors, and shareholders. This narrow definition also encompasses the relationship of the corporation to stakeholders and society.

However, in the broader version of his definition, corporate governance encompasses the combination of laws, regulations, listing rules, and voluntary private sector practices that enable the corporation to attract capital, function efficiently, generate profit, and meet both the legal obligations as well as the ethical expectations of society generally. Furthermore, he states that, no matter what is the definition, corporate governance is basically about the means by which a corporation assures investors that it has in place well performing management who ensure that corporate assets provided by investors are being put to appropriate and profitable use.

Millstein (1998a) further found when looking at the question of "for whom the corporation was governed" a number of different models of corporate governance. Some countries, mainly in continental Europe, focus on the need to satisfy societal expectations, in particular, the interests of other "stakeholders," defined to include suppliers, creditors, tax authorities as well as local communities. However, others mostly the Anglo-Saxon countries gave precedence to the primacy of ownership and property rights with the focus of their corporate objective being to return a profit to shareholders over the longer term. In addition, the report issued in 1998 by the OECD Business Sector Advisory Group on Corporate Governance also known as the Millstein Report (1998) found that maximizing long-term shareholder value encourages investment capital to be put to the most efficient economic use and this in turn benefits society.

The Millstein Report (1998) goes on to add, however, that stakeholder and shareholder interests are not necessarily mutually exclusive. The report observes that corporations do not succeed by consistently neglecting the expectations of the other stakeholders; however at the same, time they can't attract much needed capital from the equity markets if they fail to meet shareholders' expectations of a competitive return on their investment. Hence, the most successful corporations from the corporate governance perspective are those that are able to strike the right balance between the interests of shareholders and the interests of the other stakeholders.

We have recently seen this observation taking form in real life, in the case of factory collapses in Bangladesh. Large manufacturers and retailers have been driven through social pressure to ensure safe and appropriate conditions for workers in their offshore low cost supply chains. Buyer resistance to products sourced from manufacturers who are perceived to exploit workers overcomes other advantages of such supply chains, at least to the extent that action is taken to ensure minimum acceptable standards of employment for workers at the labor-intensive end of the supply chain. It is intuitive that if not addressed in this way, buyer resistance would reduce sales and profitability, which would flow through to reduced satisfaction of investors and ultimately to reduced accessibility of capital.

The Importance of Effective Corporate Governance

As a result of globalization and the increasing complexity of business, there is a greater reliance on the private sector as the engine of growth in both developed and developing countries. Corporations are legal entities created by societies because they are an efficient form of organization and society benefits from their existence. Corporations contribute to economic growth and development, which in turn leads to improved standards of living as well as the alleviation of poverty. The end result of all this activity is the creation of more stable political systems.

Furthermore as noted by Gregory and Simms (1999), the quality of corporate governance is important since it has a direct impact on the following:

1. The efficiency with which a corporation employs assets.
2. Its ability to attract low-cost capital.
3. Its ability to meet the expectations of society.
4. Its overall performance.

The Efficiency with which a Corporation Employs Assets

Effective corporate governance ensures the optimal use of resources, identified as financial, human, intellectual property, information, physical assets, and relationships as identified by Weill and Ross (2004), both intrafirm and interfirm. With effective systems of corporate governance, debt and equity capital will go to those corporations capable of investing it in the most efficient manner for the production both of highly demanded goods and services as well as those with the highest rate of return. This helps to protect and nurture scarce resources, thereby ensuring that societal needs are met. In all probability, this will mean that incompetent managers are replaced. These efficiency effects both as to scarce resources and the quality of managers should apply whether a firm is a state-owned enterprise, a private closely held firm owned by a family group, or a publicly traded corporation on a stock exchange.

Its Ability to Attract Low-Cost Capital

Effective corporate governance also helps to lower the cost of capital by improving the confidence of both foreign and domestic investors that their assets will be used for the purposes agreed. A survey of institutional investors by Felton (1996) found that they would willingly pay on average well over 10 percentage points more for a "well-governed" company, all other things being equal. In competitive markets, this means that managers must constantly evolve new strategies to meet the changing circumstances. This requires that managers be empowered to make decisions. However, as observed by that famous 18th century economist Adam Smith (1776), managers may have incentives to act in their own self-interest under such circumstances. Jensen and Meckling (1976) found that when firm ownership is separated from control, the manager's self-interest may lead to the misuse of corporate assets, for example, through pursuit of overly risky or imprudent projects. Therefore, we need to have in place rules and regulations to protect the best interests of the providers of capital. They include the following:

- independent monitoring of management;
- transparency about the performance, ownership, and control of the corporation; and
- participation in certain fundamental decisions by the shareholders.

Its Ability to Meet the Expectations of Society

For long-term success, corporations must comply with the laws, regulations, and expectations of societies where they operate. Many corporations take their role as corporate citizens seriously, thus contributing to civil society. Regrettably however, some corporations are opportunistic and seek to profit from child labor or act without regard for the environment. The latter are not merely failures of corporate governance but are symptomatic of the larger failures of government to provide the framework needed to hold corporations responsible for issues that are also important for society at large. We may interpret that when corporate governance is focused primarily or solely on financial outcomes, inappropriate behavior may emerge that then requires remedy through regulation and legislation. An alternative and possibly more effective and flexible approach to alleviate these problems might be for corporations to embed core ethical values similar to those embedded in the principles of responsible management education (PRME), such as corporate responsibility and sustainability. The former might include among other things prohibition against employment of child labor, fair working conditions including conducive work environments as well as issues like sustainability to ensure that corporations provide sustenance and job security to their employees over the longer term. Such an approach would, in addition to driving alternative outcomes in corporate and social performance, further illustrate the difference between the provision of behavioral guidance through broad principles vis-à-vis the imposition of standards through rigorous legislation that may contain inadvertent gaps.

Its Overall Performance

When corporate governance is effective, it provides effective oversight of managers and holds boards and managers accountable in their stewardship and utilization of corporate assets. This oversight and accountability combined with the efficient use of resources, improved access to lower-cost capital, and increased responsiveness to societal needs and expectations should lead to improved corporate performance. Effective corporate governance should make it more likely that managers focus on improving firm performance and are replaced when they fail to do so. A study carried out by Millstein and MacAvoy (1998) in the United States analyzing data from 1991 to 1995 found that U.S. corporations with active and independent boards of directors generated higher economic profit, hence supporting the reasonable assumption that corporate governance matters to corporate performance. Among other things, effective corporate governance should ensure that managers are adapting themselves and the corporations they manage to changing circumstances such as those arising from geopolitical, societal, and technological change. Effective corporate governance also helps to reduce corruption in business dealings by making it difficult for corrupt practices to develop and take root in a company.

The Components of Effective Corporate Governance

Gregory and Simms (1999) observed that corporate governance practices vary across countries and industries, reflecting differing societal values as well as differing ownership structures, business, and competitive conditions. It can also be due to differences in the strength and enforceability of contracts, the political standing of shareholders and debt holders as well as the development and enforcement capability of the legal system. In the developed countries, the elements of effective corporate governance include well-positioned and regulated securities markets; laws that recognize shareholders as the legitimate owners of corporations while at the same time ensuring the equitable treatment of minority and foreign shareholders; enforcement mechanisms protecting the rights of shareholders; laws to protect against fraud on investors; sophisticated courts and regulators; and an experienced accounting and auditing sector and significant corporate disclosure requirements. In addition to this, the developed countries also have well-developed private sector institutions such as organizations of institutional investors, professional associations of directors, corporate secretaries and managers, as well as rating agencies, securities analysts, and a sophisticated financial press.

On the other hand, many emerging countries have not yet fully developed their legal and regulatory systems, enforcement capacities, and private sector institutions required for effective corporate governance. There is, in many of these countries, a need for further development of the stock exchange, systems for registering share ownership, enactment of laws for the protection of minority shareholder interests, the empowerment of a vigilant financial press, the improvement of audit and accounting standards, and a paradigm shift in the mindset against the widespread tolerance of bribery and corruption as an unavoidable cost of doing business in some of these countries.

On top of differences in the stage of development of individual countries legal and regulatory system, they also differ remarkably in the cultural values that underpin their financial infrastructure as well as their chosen model of corporate governance. Greenspan (1999) in his remarks to the World Bank and the IMF noted that the development of financial infrastructure and all the institutions that support it is "invariably moulded by the culture of a society." In the final analysis, corporate governance, and the framework underpinning, it must be pertinent to each country's unique legal environment and cultural values.

We should understand from the foregoing that concepts and models for corporate governance are continuing to evolve in a manner that will be driven by evolving expectations of corporate and government behavior and the evolving characteristics of society at its various levels.

According to the Millstein Report (1998), corporate governance takes place within the corporation and as such it depends very much on investors, boards, and managements for its successful implementation. The report noted that for corporate governance to be effective, it must focus on four important areas:

- Fairness by ensuring the protection of shareholder rights, in particular, the rights of minority and foreign shareholders. These rights can be strengthened by ensuring the enforceability of contracts made by the providers of capital.
- Transparency by the timely disclosure of adequate, clear, and comparable information concerning corporate performance, governance, and ownership.
- Accountability by clarifying governance roles and responsibilities and by means of voluntary efforts to ensure

the convergence of managerial and shareholder interests as monitored by the board of directors.

- Responsibility by ensuring corporate compliance with other laws and regulations reflecting the extant society's values.

In summary therefore, the Millstein Report (1998) urged the promotion and articulation of the four core standards of corporate governance: fairness, transparency, accountability, and responsibility. As a response to the Millstein Report recommendations to promote and articulate the four core standards, the OECD set up a Task Force to operationalize the findings. In April 1999, the Task Force issued a set of corporate governance principles building on the four essential components articulated by the earlier Millstein Report (1998). The principles provide useful working guidelines to countries seeking to further strengthen the foundations of their corporate governance practices by expanding on the core concepts identified earlier by the Millstein Report (1998).

Fairness

In relation to this core concept, two separate principles were developed. The first principle states that "the corporate governance framework should protect the rights of shareholders." This includes both their proprietary as well as their participatory rights. Effective corporate governance depends on laws, procedures, and practices that protect their property right and ensure the security of ownership as well as the unfettered transferability of shares. This principle also recognizes their participatory rights on key corporate decisions such as the election of directors and the approval of major mergers or acquisitions. The second principle states that "the corporate governance framework should ensure the equitable treatment of all shareholders including the minority and foreign shareholders and that all shareholders should have the opportunity to obtain effective redress for violation of their rights." This means that the legal framework should include laws that protect the rights of the minority shareholders against misappropriation of assets or self-dealing by the controlling shareholders, managers, or directors.

Responsibility

The third principle states that "the corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises." This means that corporations must abide by the laws and regulations of the countries in which they operate. However, laws and regulations impose only minimal expectations as to conduct and corporations should be encouraged to act responsibly and ethically with special consideration for the interests of stakeholders particularly the employees. It is now acknowledged that socially responsible corporate conduct is consistent with the principle of shareholder wealth maximization. In numerous countries around the globe, the practice of corporate social responsibility accounting is now well established, with corporations going beyond the legal requirements to provide health care and retirement benefits, financially supporting education, and formulating and adopting environmentally friendly technologies. Similarly other companies strive to avoid practices, which are socially undesirable even if not prohibited under the law.

Transparency

The fourth principle states that "the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation including the financial situation, performance, ownership and governance of the company." This is in recognition of the fact that both investors and shareholders need information regarding the financial and operating performance of the company as well as information about their corporate objectives and material risk exposures. This information should be prepared in accordance with internationally acceptable accounting and auditing standards and should be subject to an independent audit, which is conducted annually. The use of internationally accepted accounting standards would enhance comparability and assist both investors and analysts in comparing corporate performance and decision making based on their relative merits. Likewise, information about the company's governance such as share ownership, voting rights, identity of board members, key executives, and executive compensation is also a critical component of transparency.

Accountability

The fifth principle states that "the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board as well as the board's accountability to the company and the shareholders." This principle implies a legal duty on the part of the directors to the company and its shareholders. The directors are said to have a fiduciary relationship to both the shareholders and the company, which requires that they avoid self-interest in their decision making and act diligently and on a fully informed basis. This principle also recognizes the duty of the board to oversee the professional managers who have been entrusted to run the company and who are accountable to the board for the use of firm assets. Thus, the board acts as a mechanism for minimizing the agency problem inherent in the separation of ownership and control. If the board is to be an effective monitor of managerial conduct, it must be suitably distinct from the management in order to be objective in its assessment of management. This requires therefore that there are nonexecutive directors on the board who are neither members of the management team nor closely related to them through family or business ties. A critical aspect of effective corporate governance is the quality of the directors. Objective oversight, therefore, necessitates the participation of professionally competent nonexecutive and independent directors on the board. The latter must have the capability, fiduciary commitment, and objectivity to provide strategic guidance and monitor performance on behalf of the shareholders. In order for the board to be able to play their roles effectively, they should meet often, at least once every three months and if possible more often. Additionally, for the nonexecutive directors to be effective and to ensure that independent oversight has meaning, they must have access to important information in advance of board meetings. In the developed countries, board committees have played an important role in performing detailed board work. In these countries, it is common to rely on an audit committee, remuneration committee, and a nomination committee staffed either wholly or primarily with nonexecutive or independent directors. The four core principles of effective corporate governance enunciated by the Millstein Report (1998), namely, fairness, transparency, accountability, and responsibility as subsequently expanded into the five OECD principles of corporate governance require both regulation and private sector initiatives for implementation. The former to ensure that minimum standards are met and the latter private sector effort to make sure those codes of conduct and voluntary behavior exceed the minimum legal requirements.

Bias to Principles

It is noteworthy that the vast majority of guidance available on corporate governance—whether sourced from the foundational work in the Cadbury Report, compiled by OECD, developed by the IoD in South Africa's King III Report or in listing rules for various stock exchanges—is presented in the form of principles, rather than in the form of fixed methods and rules. Such an approach is generally argued as giving each organization the freedom to arrange and conduct its own affairs without undue interference from government, while maintaining the capability of the judiciary to form well-founded judgment regarding the conduct of the organization and its governing body in the event that allegations of improper conduct are raised.

While principles remain the mainstay of guidance on corporate governance globally, there are increasing procedural demands on governing bodies of all types, holding the various types of director more and more accountable for conformance and performance. It may be an oscillating trend pushing deep and then pulling back a little as seen earlier with the Australian Labor Government's recent approach to governance of not-for-profit organizations now being softened by the current Coalition Government, and similar imposts on small and medium enterprise (SME) directors. While these observations are made in the Australian context, we should not be surprised to see that there is evidence of similar trends globally. We also see trends to government adoption of more and more commercial like models for governance at boards of some Australian government agencies; South Africa's King III guidance being reflected in its own governance models for government agencies, and OECD principles for corporate governance being adapted and refined for governance of government agencies in some OECD member countries.

Notwithstanding the emergence of procedural demands, there remains an important consideration that process-and-structure approaches to corporate governance are likely to create conformance and overhead difficulties for organizations outside the narrow range on which the procedural approach is modeled and optimized. A principles-based approach to governance permits each organization to adapt its own process and organizational approach to the task of conforming to the principles, allowing corporate governance to be optimized while continuing to meet the demands of government and society. At the same time, a principles-based approach allows an enforcement approach that is not constrained by strict and narrow interpretation of fixed rules. For example, a prescriptive approach to controlling misuse of market power by large corporations may be circumvented merely by exerting power in a way that is not identified in the prescriptive rules, while a principles-based approach that merely specifies that market power must not be used to unfairly disadvantage a supplier allows the courts to determine on a reasonable basis what is and is not an unfair disadvantage and whether or not market power has been abused to create such disadvantage. Thus, we see that while principles-based approaches to corporate governance give flexibility in how organizations implement their governance arrangements, they also give flexibility and power to the judiciary that can result in a more effective enforcement regime than is possible when strict and fixed rules and procedures are mandated.

The United States found to its immense cost that a strict rules-based formulation to corporate governance pre-2002 failed to stave off the Enron scandal in October 2001. The latter in turn led to fast track legislation through the Congress resulting in the now famous Sarbanes-Oxley Act 2002 (Sarbox 2002), making its disclosure requirements mandatory for all corporations wishing to list on U.S. bourses. Arguably Sarbox 2002 is less prescriptive than earlier regulations pre-Enron.

Improving Board Governance

According to Bhagat, Hirt, and Kehoe (2013) the authors of the 2013 McKinsey global survey on governance report, board directors today are more confident in their knowledge of the companies they serve and are more strategic in their approach than they were in 2011. Their survey found that boards spend a greater portion of their time on strategy, while they are spending less time on mergers and acquisitions. While directors now report a more complete knowledge of various company issues than they did before, they also say that boards struggle to understand and make time to manage business risks one of several areas where directors indicate there is room for further improvement. Across the functional areas of their work, nearly half the directors surveyed say that their boards have been most effective at strategy, far outpacing all other areas. According to the authors, two reasons may explain why boards are most effective at strategy: board members say they spend more time on it than other areas and that they have increased the amount of overall working time they devote to strategy. The authors note that although boards are taking on more responsibility for strategy, risk management is still a problematic area perhaps because boards are less focused on risks, as companies move further away from the 2008 financial crisis. Despite the progress they report, directors identify the same factors that would most likely improve board performance: a better mix of skills or backgrounds, more time spent on company matters, and better people dynamics to enable constructive discussions. Looking ahead the authors suggest that boards need to improve their governance by the following:

- Devoting more attention to risk than they currently do. One way to get started is by embedding structured risk discussions into management processes throughout the organization.
- Spending more time on board work since the results suggest real benefits from doing so as directors at higher-impact boards spend many more days per year on their work than everyone else; this probably helps them stay more relevant to and engaged with important company matters.
- Learning from the actions taken by higher-impact boards not just when it comes to strategy. Using robust financial metrics, conducting postmortems of major projects, and using systematic processes to create competitive advantage, which the high-impact boards do more often, could all help boards become better engaged.

Governance in the Digital Era

There has been a lot of interesting and telling commentary lately about the role boards need to play governing in the digital era. PriceWaterhouseCoopers (PWC) published their "Annual Corporate Director's Survey" (PWC, 2013). The Information Age announced that the UK government was going to provide FTSE 350 companies with the opportunity to evaluate their cyber-security risk (Swabey 2013). The Guardian has published a piece about how the "Abandoned NHS IT system has cost £10bn so far" (Syal 2013) and multiple consulting and research firms and peak governance bodies are publishing or republishing editorial about the questions boards need to ask about IT governance. The common thread that runs through these articles and publications is enterprise technology governance (ETG), which refers to the urgent need for boards to better understand risk and opportunity when it comes to their role in technology governance.

Surprisingly enough, it seems that too many company directors still honestly believe that boards have no business "meddling" in ETG. They skirt around the issue with comments such as "It's about better governance not better technology" or "We're not in a high-tech industry." Their dogged adherence to predigital models of corporate governance and their failure to act is putting their organizations at risk. The latter include technology risk; infrastructure risk; IT project risk; business continuity risk; information and security risk; and IT competence risk (Parent and Reich 2009), which could easily blind-side a board because the directors simply weren't able to ask the right questions of management, supply partners or advisors. The IT Governance Institute (ITGI, 2011) reported that 21 percent of IT projects worldwide are terminated before completion. These findings seem contradictory when more than 90 percent of both company directors and senior directors surveyed since 2011 have consistently rated technology as critical to their businesses. Technology underpins how they do business, their operational effectiveness, their cost savings as well as their capital investment plans, and their engagement with stakeholders.

Even in today's technology-saturated business and economic environment relevant technology-governance competency (knowledge, skills, and experience) is only present in between 16 and 20 percent of boards globally and around 30 percent for companies in high-tech industries (Eisener-Ampler 2012; ITGI 2011). Malcolm Marshall, KPMG's global head of information protection and resilience, is quoted as saying "It is no exaggeration to suggest that data central to national security and economic growth is at risk of exposure, meaning that it is boards and not the IT team which must take responsibility for their cyber security levels. It may be tempting to delegate cyber strategy to IT, but to do so is to delegate responsibility for the business's whole security, as well as that of every customer and supplier" (Swabey 2013). Van Grembergen and De Haes (2009, 2012) have been making this point for years. Board ethics and performance commentator Dr. Karen Martyn (2013) refers to Bayles' (1989) seven fiduciary obligations, one of which is the obligation of competency. These professional obligations are applicable to board governance. They refer to how a board or individual director is seen to behave in trustworthy ways such that stakeholders can be assured that they are performing at a level that promotes the investor or funder's interests. Although not a moral virtue, competence is probably the most crucial of a professional's characteristics. Professionals have an ethical responsibility not to hold themselves out to do or accept work such as governing if they are not competent to handle it. No matter how honest, candid, diligent, loyal, fair, and discreet professionals are, if they are incompetent, they are unworthy of trust, for they cannot do the jobs for which they are hired well (Martyn 2013, 4). The recent Guardian article suggests that "successive ministers and civil servants have been blamed by committee members for the NHS project failure, which has been described as the biggest IT failure ever seen with the NHS's particular problems stemming from the original contracts signed before 2002" (Swabey 2013). In an era where big data connects previously unconnected dots relating to all types of performance and where social media is the platform for ever-increasing transparency and critique, there may be a very different road ahead.

Competence in the role of company or advisory board director is a fiduciary obligation and boards have been warned that ignorance of these matters is no longer an acceptable defense, as in the case of Australian Securities and Investments Commission v Healey (20110) 278 ALR 618; [2011] FCA 717, commonly known as the Centro Judgment. The obligation of boards in respect of human resources and other assets and dealings have all been similarly reinforced. In a similar manner, and as noted by Valentine (2013), corporate boards are likely to come under increasing pressure to ensure that board members are properly informed of, and competent to discharge their obligations in respect of oversight of the organizations management and use of information and digital technologies.

Enterprise Technology Governance Issues

According to Willmott (2013), board members should review nine critical issues when discussing technology strategy with their management. Some organizations are creating new technology forums, building the expertise of corporate directors, and strengthening IT governance with the aim of allowing boards to guide management by asking the right questions about technology especially when digital technologies are beginning to disrupt industries and mastering these technologies may be the key to long-term survival and success. Willmott (2013) observes that although the particulars of each company's situation will differ across industries, every corporate director whether IT savvy or not will benefit from reviewing the following issues with their management about what the company needs to do to enhance its ETG.

In common with many past technology developments, there continues to be substantial marketing hype attached to individual aspects of the larger phenomenon of the digital revolution. Such hype has resulted in many commentators becoming overly focused on one aspect of technology, such as mobility, big data, and social networking. Casual observation of organizations that are focusing on a subset of technologies suggests that while they may be gaining in the areas of focus, they may well be losing in areas that are not garnering such attention. For example, in the banking arena, many banks are investing heavily in mobility-based payment solutions, but the ones that are gaining the strongest competitive advantage are the ones that are complementing these payment solutions with new, robust, real-time core account keeping systems.

An important consideration for the governing body thus is to ensure that management is taking a balanced perspective on technology development, rather than being seduced by contemporary fashion. This is not to say that boards should discourage overhaul of the organization's capabilities through the use of modern technologies—but rather to say that boards should ensure that the overall plan for evolution takes best advantage of both new technology capabilities and the way in which other organizations are themselves adopting and adapting to the digital era.

In considering the adoption of new technologies, boards should ensure that their organization has a sound grasp of the role of technology as an enabler of business capability—paying particular attention to the mid-1960s guidance of Leavitt, as reiterated by Toomey (2009 2014), which says that successful organizational change demands balanced attention to four fundamentals of organizational capability—the people who do the work (including increasingly in the digital era, customers, suppliers, and contractors), the processes through which the work is done, the structure and rules within which the work is done, and the technology that enables the operations. Investing in technology for technology's sake has long been proven to be an excellent method of wasting money, where successful organizations have equally demonstrated that investment in technology as an enabler to properly planned and executed organizational change (and capability development) carries a high probability of delivering above-average returns.

The Role of IT in Changing the Basis of Competition Across Industries

Technology is making the boundaries between industries more porous and providing opportunities for competitors. For example, in the banking industry, online consumer-payment products using a mobile application and device that enables merchants to accept payments are challenging traditional payment solutions. Some telecommunications providers have captured significant market share by offering inexpensive mobile voice and data plans, in part by offloading some of its traffic onto the home Wi-Fi access points used by its broadband customers. For incumbents in many sectors, technology is becoming an arms race. Companies are harnessing technologies such as social media and location-based services to reinvent the customer experience and capture market share.

Exceeding Customers' Expectations in a Digital World

Customers are being educated by leading companies in e-commerce to expect an ultra-convenient experience, personalized in real time. Competitors in many industries are differentiating themselves from incumbents through convenience and service. As a result, customer expectations are rising quickly. Simply meeting these enhanced expectations can be a major effort for organizations that are not digital savvy. The bar is high for satisfying customers in a digital world. Doing so requires investment in sophisticated big-data capabilities that use social, location, and other data, for example, to attract potential customers. It also requires intimate understanding of and appropriate response to new behaviors adopted by the emerging "digitally empowered" marketplace in which people as individuals and as communities (some of which form on an ad hoc basis in response to a perceived or real emerging issue) use powerful communication tools such as Twitter, Facebook, and YouTube to exert pressure on organizations that do not meet their expectations.

Business Plans Utilizing the Full Potential of Technology to Improve Performance

Technology expenses can be high, but they are relatively small compared with their potential to boost the operating performance of the business. Technology can improve business performance by driving revenues, reducing overall costs, and lowering risk costs. Technology can also have a negative impact on performance, for instance, by reducing margins given increased transparency about pricing in the market. By seizing the opportunities and mitigating the threats, companies can dramatically improve their performance. Ultimately, the strategy that emerges from an assessment of opportunities and threats should be an integrated plan that shows how the business will beat the competition by using information over the long-term horizon. By correctly reading the scale and scope of the opportunity and threat, the level of investment in IT becomes an outcome rather than a constraint.

Alignment of Technology Investments with Opportunities and Threats

Technology investments should clearly reflect the business opportunities and threats at stake. They should also be dynamic and balance short-term opportunities against carefully chosen longer-term bets. For instance, many companies recently cut investment in the Internet channel as customers switched to mobile applications. On average, large IT projects run 45 percent over budget and 7 percent over time, while delivering 56 percent less value than predicted. Monitoring the investments carefully and deploying effective processes that ensure that value will be created can manage these risks.

Using IT to Improve Operational and Strategic Agility

IT has a significant effect on both operational and strategic business agility. Leading businesses are continually using IT to improve their business agility. Business agility is underpinned by the agility of the IT function itself to design and implement changes to systems rapidly at low cost and risk. IT agility can also be increased by changing the systems landscape, improving data quality, optimizing IT delivery processes, and building flexibility into sourcing arrangements. Leading businesses measure and manage both business and IT agility, ensuring that the business can respond competitively.

Deriving Value from IT

Technology in itself delivers no value. It's the combination of a clear strategy, the right technology, high-quality data, appropriate skills, and lean processes that add up to create value. Any weak link in this chain will lead to poor value delivery from IT. Leading organizations actively assess their capabilities in these areas and target their weak spots. In many sectors, a shortage of IT-literate talent in the business is creating a bottleneck. Contrary to popular belief, the majority of executives can, with the appropriate training, learn how to derive value from IT. Capability building must start at the top and some companies have put their top 200 managers through IT training workshops as a way to kick-start the process.

Accountability for IT

In most organizations, accountability for functions such as finance and human resources is clearly laid out. In human resources, for example, performance can be tracked using a scorecard of intuitive business metrics such as attrition rates. However, accountability for IT is not always so well defined. The so-called shadow IT functions such as IT developers hired into the marketing department to build social-media applications can sometimes be out of reach of the core IT function. The emergence of roles such as the chief digital officer and chief data officer can further confuse the picture. Moreover, the IT function can't be held solely accountable for delivering value from IT. Lower process costs, for example, benefit business units and functions other than IT. Leading organizations define a clear IT operating model, which determines exactly who is accountable for IT activities such as developing applications, managing data quality, or implementing IT solutions in business processes. The operating model must be aligned with business priorities. Whatever the model used, heads of IT departments should be held accountable through scorecards that measure value delivered to the business in the form of efficiency, agility, and risk levels.

Level of IT Risk

Cyber security is a significant and growing IT issue. Many large companies' security has been breached, and most executives have a poor understanding of the risks. But cyber-attacks are just one category of IT risk. A failure of a small software component can cost a company a lot of money in customer compensation. IT systems can also cause business-conduct risk—for instance, if automated recommendations to cross-sell products conflict with regulatory requirements. Companies need a comprehensive system for managing IT risk that assesses the full range of risks (for example, hacking attacks, vendor failure, and technical failure) and addresses the root causes, which include redundant technology, incorrect policies, poor processes, and insufficient oversight.

Communication of IT Strategies

IT is already on the minds of analysts, customers, regulators, and shareholders, and interest will rise as enterprises become increasingly digital.

In many industries, digital is likely to become the predominant sales channel. Companies should therefore be ready to communicate their IT strategies externally.

Principles for Responsible Management Education (PRME)

The mission of the PRME initiative is to inspire and champion responsible management education, research, and thought leadership globally. The PRME is inspired by internationally accepted values such as the principles of the United Nations Global Compact. They seek to establish a process of continuous improvement among institutions in order to develop a new generation of business leaders capable of managing the complex challenges faced by business and society in the 21st century. In the current environment, these include issues like corporate responsibility and sustainability. Taking the six PRME as a guiding framework, institutions are encouraged to integrate corporate responsibility and sustainability in a gradual but systematic manner. Since this chapter is mostly about the board's role in ETG, these principles can be adapted to address the important task of continuing board education, with particular emphasis on what we might call digital education. As it is becoming clear that established aspects of boardroom accountability such as the long-term sustainability of the organization and the day-by-day capability of the organization to maintain effective operations are now profoundly dependent on effectiveness of IT-enabled business systems and the suitability of long-term IT-enabled business strategy, it is imperative that those engaged in the core roles of corporate governance build the skills to effectively oversee management in these critical areas. While it should not be expected that board directors develop specific technology skills, there should be no doubt that board directors must develop the skills to assess the potential impact of technology on the organization and the markets in which it operates. Such impacts must necessarily include the potential for emergence of new competitors and products, the emergence of new complementary products and services, the extension of supply and customer chains, geographic expansion, and increasing power and independence of market players including customers, regulators, suppliers, and lobbies. The latter might include some or all of the following initiatives depending on the circumstances of individual boards:

- comprehensive development of boardroom competencies in governance of IT, including ability to apply the guidance and principles in the international standard for governance of IT, ISO/IEC 38500;
- formal and regular boardroom briefings on the nature of current and planned business use of IT and management arrangements pertaining to such use;
- formal and regular boardroom briefings on developments in the capability and use of IT, with particular emphasis on competitive considerations addressing both the opportunity for the organization to obtain competitive advantage and the potential for competitive threat from other organizations;
- building the capability of board members to understand the current digital revolution by building their individual and collective participation in the digital era through initiatives such as moving major parts of board service to the online environment and encouraging board members to use relevant company systems, including in particular those that are customer facing.

At the same time, organizations should also seek to ensure that management is fully competent to plan, build, and run the digitally enabled organization of the future. It is no longer sufficient for management to leave strategy for IT to the IT specialists, as IT is in fact now a critical consideration in formulation of business strategy. Organizations that fail to consider IT in the formulation of their business strategy are at considerable risk of failure, as has been seen with, for example, HMV, Blockbuster, and Kodak. In particular, governing bodies should ensure that the following:

- top-level business managers have a complete understanding of how their respective parts of the business currently use, are constrained by, and have competitive opportunity in the organization's existing IT capability, including externally sourced capability;

- top-level business managers have a sound grasp of how technology capability is evolving in the market, and how current and prospective entities operating in their market may change the competitive landscape through innovative use of new technology;
- arrangements for governance of IT ensure that there is appropriate top-level responsibility and accountability for the use of IT as a critical enabling resource, that business strategy includes consideration of technology at an equal or higher level of importance to human and financial resources, and generally conform to the guidance laid out in the international standard for governance of IT, ISO/IEC 38500; and
- management systems pertaining to the use of IT are fit for purpose in the digital era, delivering the service levels, flexibility, and performance required to remain competitive, and conform to the governance arrangements previously mentioned.

Conclusion

There is a heightened awareness worldwide that effective corporate governance as manifested by transparency, accountability as well as the just and equitable treatment of shareholders is now a prerequisite toward efforts to promote sustainable development. Toward this end, there is a need for both public (as represented by governments) and private sector partnership to raise the awareness of the importance of corporate governance improvements and to assist in implementing corporate governance reform. However, such efforts must be mindful of the fact that every country has its own culture as well as differing social and economic priorities. Similarly, every corporation has its own corporate culture and business goals. All of these differences will impinge on questions regarding the most practical corporate governance structures, models, and practices to be adopted both by sovereign nations and individual corporations. Therefore at this point in time, to get a consensus on a single model of corporate governance or a single set of detailed governance rules is both unlikely and unnecessary. It is expected that over time the dictates of the capital market will lead to increasing convergence in practice between countries. This together with globalization and the attendant fall in regulatory barriers between countries will ensure that investment capital flows to those corporations that have adopted efficient corporate governance standards including internationally acceptable accounting and auditing standards; adequate investor protection mechanisms as well as board practices designed to provide independent and accountable oversight of management. These traditional models of corporate governance will, however, have to be revamped and updated to take account of the latest developments in ETG. For instance, the Australian government recently replaced all but two of the incumbent National Broadband Network board because they did not have the relevant knowledge, skills, experience, and competencies. The latter is defined as the competency view of directing, not just in IT. IT has become so pervasive though that even the other more established disciplines need to have greater knowledge of the competitive risks and opportunities relating to technology in their fields. Imagine hiring a marketing guru onto a board who has no knowledge and skills in the use of the Internet as customer sales and engagement channel, the use of social media in advertising and communications, a legal counsel without any experience or skills in data security and intellectual property law, or a finance and economics specialist from the predigital economy. Technology is not just another technical discipline like marketing or human resources. It is shaping and changing how we all live, work, and play, besides creating whole new ways of doing business and engaging with customers and staff. It is providing data on a scale and with a level of interconnectedness that we have never seen or experienced before and therefore it cannot be ignored. Although there are still some corporations that are doing a fairly good job of getting the balance and mix of competencies right, they are still few and far between as amply highlighted by both the recent NHS scandal in the United Kingdom and Queensland Health debacle in Australia.

We should note, however, that evolving models for governance and increasing regulation focused on the governing entity are in part responses to evolving expectations of society and that society is using new tools such as social media to bring new pressure to bear on governing bodies. It is arguable that further evolution may lead to new ownership, stakeholder engagement, and participative governance models for corporations as well as for nations and states. We cannot predict what will happen in the future, but we can see from history that innovation in the use of technology is often disruptive and only delivers optimum outcomes when there is balanced attention to the entire system of business (or governance, or government, or whatever is being affected), addressing the people involved, the processes by which things happen, and the rules and structures that apply, as well as the technology. To be specific, evolving corporate governance to a substantially democratic model of shareholder participation requires new procedures to supply information and manage the engagement, up skilling and dialog with shareholders, rules and protocols for shareholder participation in the more democratized arrangements for governance, and technology resources to enable the engagement to happen.

To sum up, Chatrath (2013) notes that a fair and effective corporate governance framework must evolve in the light of changing circumstances of business over time and the framework of the company should be tailored accordingly to deal with those circumstances. A poorly conceived governance system, on the other hand, can wreak havoc on an economy by misallocating resources or failing to check opportunistic behavior. The question that often arises is whether corporate governance operates the same way in every economy. It may be argued that cross-national patterns of corporate governance are either converging or will converge on either the Anglo-Saxon shareholder-centered model found in the United states and the United Kingdom, or a hybrid between the shareholder and stakeholder models typically found in Japan and Germany. Chatrath (2013) concludes by stating that, irrespective of the model adopted, overall corporate governance (including the enterprise technology aspect) and competitive strategy of organizations are inextricably linked.

Several of the kinds of disruptive technologies highlighted by McKinsey reports such as the cloud, 3D printing, automation of knowledge work, and so on will begin to level the playing field between big and small organizations. This implies a more varied competitive environment wherein competitive power is based on agility and the ability to implement new technologies, adapt to new market conditions, respond to changing consumer behavior, adopt new business models, and satisfy new and evolving regulatory requirements, rather than on size and geographic location. The challenge then is for boards to ensure they remain effective in this environment. The latter can be done either by sending board members out for the requisite training and exposure or else head hunting for the required expertise from outside the company and bringing them on board.

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Discussion Questions

1. Differentiate the two versions of corporate governance as defined by Millstein.
2. Why is the quality of corporate governance important?
3. Briefly describe the four important areas that contribute to effective corporate governance.
4. Describe briefly the aspects that boards need to consider to improve their governance.
5. What are some of the issues identified as critical for Enterprise Technology Governance (ETG)?
6. What are the six Principles of Responsible Management Education (PRME)?

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CHAPTER 5

Responsible Governance and Financial Accountability: International Perspectives for the New Era

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Abstract

This chapter provides an empirical and practical approach to governance, financial accountability, governmental rules, and organizational culture through management control systems in nonprofit publicly funded higher education institutions. More specifically, this chapter focuses on the overlaps and gaps between the themes of changes in the external and internal strategic environment of the higher education industry (i.e., external and internal strategic analysis) and formal versus informal management control systems, which are related to financial accountability systems from the government and political parties in power as well as the organizational culture within higher education institutions in Western Canada (i.e., case study).

Keywords: Financial Accountability, Management Control System, Governance, Higher Education.

Management control systems have been well documented over decades of research. Despite the significant body of descriptive empirical and theoretical data in the field, there remains a paucity of case studies describing and explaining the interrelationships between changes in the external and internal strategic environment and management control systems with a case study design.

The aim of this chapter is to explain and describe these interrelationships in the context of the higher education industry in Western Canada and to provide speculative recommendations for policy makers and executives in the industry.

Background

This chapter focuses on nonprofit publicly funded higher education institutions in Western Canada. The Western Canadian higher education institutions discussed in this chapter include all nonprofit and publicly funded academies, universities, colleges, and other collegiate-level institutions that award academic degrees, diplomas, and/or professional certifications in Western Canada (Boyko and Jones 2010). Although the geographical denomination of Western Canada is very broad, it refers to the provinces of Alberta and British Columbia (i.e., BC) in this chapter. In Canada, higher education is governed by provinces and territories as opposed to the federal government (i.e., British North America Act 1867; Constitution Act 1867). This characteristic leads to major differences and incompatibilities in terms of the systems in place between provinces and territories. However, Alberta and BC have memorandums of agreements (e.g., Alberta BC memorandums 2007) aiming at offering systems that are comparable and aligned with each other. Indeed, Alberta BC memorandums (2007) involve a series of agreements on the following:

- protocols for a collaborative strategic approach;
- protocols for cooperation and development in acquisition and learning resources;
- protocols for credit transfers between Alberta and BC;
- protocols for a partnership in support of assistive technology and other specialized services to students with special needs;

- protocols for cooperation in research development and innovation; and
- protocols for cooperation between Alberta and BC presidents.

In 2007, Roles and Mandates were developed in response to recommendations from the auditor general and consultations with stakeholders. The Roles and Mandates outlined key directions for the higher education industry in Western Canada to improve its financial accountability and compliance with regulatory requirements from the government.

Responsible Governance in Western Canadian Higher Education

Management control systems, in this chapter, refer to ways control is exercised over authority delegated to higher education institutions by the government (Whittington and Pany 2012). Therefore, management control systems in the higher education in Western Canada are related to specific levels of governance with the level of the board of governors and the level of the executive leaders (e.g., president and top management team).

First, higher education institutions have a governing body (e.g., board of governors) responsible for the assets of the institution (i.e., as per Roles and Mandates) and for strategic direction. The governing body is constrained by the status of the higher education institution, its jurisdiction (e.g., national, provincial, and local regulations), and the conditions under which it may receive public and/or private funding. The governing body's formal status entails auditing and reporting obligations to the government (e.g., management control systems).

Secondly, higher education institutions have an academic body (e.g., academic board with the deans, vice-president academic, and president). The academic body's authority is formally delegated from the governing body, and its authority is exercised over all academic matters, such as admission of students, discipline of students, academic awards, and conduct of teaching and research.

Thirdly, interactions between the two bodies exist in most higher education institutions, as they are operated through joint committees bringing together members of the governing body and the academic body. This phenomenon is described as "shared governance" and is regarded as good practice in the higher education industry. The top management team is expected to have a special responsibility within this shared governance model, since the academic head of the institution (i.e., president) generally is a member of the governing body and the chair of the academic body.

Financial Accountability in the Western Canadian Higher Education

Management control systems are described by Berry, Broadbent, and Otley (2005, 3) as "the process of guiding organizations into viable patterns of activity in a changing environment." In the higher education industry, management control systems are used to exercise control over authority delegated to others (e.g., government to higher education institutions). Such systems involve developing implementation plans and associated projections to monitor progress toward the accomplishment of the implementation plans. Financial forecasts, budgeting, accounting, and auditing systems are prime examples of management control systems, as they establish goals and evaluate actual performances with yearly reporting systems overseen by independent auditing bodies (Whittington and Pany 2012).

According to Berry, Broadbent, and Otley (2005, 13), however, an important distinction can be made between formal and informal management control systems, with: (1) formal management control systems promoting clear objectives and decision processes associated with quantitative measures of performance; and (2) informal management control systems promoting "vague" objectives and decisions processes associated with ill-defined qualitative measures of performance. Both accounting systems influence executives of higher education institutions and employees' behaviors and consequently affect the degree to which strategic alignment can be achieved (Berry, Coad, Harris, Otley, and Stringer 2009).

In the higher education industry, there is relentless pressure by governments toward using productivity metrics in reporting and accounting practices (Broadbent and Laughlin 2005).

Productivity is a measure of outputs per unit of inputs and generally leads to the use of outputs/inputs ratios. Measuring productivity in the higher education industry is difficult, because outputs (i.e., success of students) are directly influenced by inputs (i.e., matriculating students) and students are vital actors who cannot be dissociated from the educational process (i.e., "associative good industry"; Broadbent 2007, 193–8). Problems in measuring inputs and outputs do not allow for straightforward outputs/inputs ratio measures and lead to the need to rely on indirect measures (Gate and Stone 1997).

As a consequence, indirect but workable definitions of productivity in the higher education industry focus on two dimensions: (1) effectiveness and (2) efficiency (Broadbent 2007; Gate and Stone 1997). Typically, effectiveness relates to the extent to which the higher education institution meets the needs and demands of stakeholders like students, faculty, local communities, governments, and industry (e.g., number of graduates or total full-time equivalent (FTE) students) (Gate and Stone 1997). Typically, efficiency relates to the level of effectiveness obtained from a given amount of resources (e.g., operating grant per FTE students) (Gate and Stone 1997).

Business indicators are used as means of measuring effectiveness in terms of programs offerings in the higher education industry. For example, typical business indicators are related to enrolments and retention-type measures, with higher education institutions reporting enrolments in terms of FTE students and percentages of students graduating in five years (i.e., outcomes related to attracting and retaining students).

Academic indicators are also used as means of measuring effectiveness in terms of research in the higher education industry. For example, typical academic indicators are related to professionalism or to the demonstration of a particular expert knowledge in a specific research area in terms of the number of peer-reviewed chapters published.

Financial indicators are used as means of measuring efficiency in the higher education industry (Broadbent and Laughlin 2005; Otley 1999). This perspective leads to the notion of "relative revenue ratio" (i.e., higher education institutions need to evaluate how research and teaching revenues compare to research and teaching costs to the government in order to guarantee their viability). For example, the consolidation of financial information is considered to be a valuable reporting and accounting tool by the government (Broadbent 2007; Broadbent and Laughlin 2005). The accounts of higher education institutions are presented according to standards and principles that are legally established (e.g., Auditor General's reports on statements of financial position as per the Auditor General Act 1985). The consolidation of accounts displays information on the higher education institutions financial status, with changes and results of transactions carried out in a way that is regulated (e.g., consolidated statements of financial position, consolidated statements of operations, changes in net assets, cash flow, and Auditor General's reports). The consolidation of accounts encourages more transparent and efficient management, since it facilitates a comparison of the financial status over time and across institutions (Broadbent 2007; Broadbent and Laughlin 2005).

It is important to note that reporting and accounting practices in terms of business, academic, and financial indicators can be fertile ground for motivated reasoning. Nonfinancial performance measures are more subjective and ambiguous to interpret than financial measures, but financial performance measures can still be affected by motivated-reasoning processes (Broadbent 2007). Any decrease in precision provides latitude for overinterpretation of evidence and motivated reasoning. Indeed, executives in search for preference-consistent information (i.e., information that confirms what executives wish to demonstrate) can find a reasonable amount of supportive data and stop searching or disregard disconfirming evidences. If reporting and accounting practices are ambiguous or complex enough to allow different assessments in terms of success for strategic initiatives, executives with different preferences tend to reach different conclusions (Broadbent 2007). This means that reporting and accounting practices might need to be relational as opposed to transactional, and to consider the context of the higher education industry (i.e., effectiveness and efficiency measures as opposed to productivity measures because the higher education industry is an "associative good industry"; Broadbent 2007, 193–8) or the culture of the higher education industry (i.e., deviance, resistance, and opportunistic behaviors) (Oakes and Berry 2009; Broadbent 2007).

The Case of the Western Canadian Higher Education

The case of the Western Canadian higher education institutions presented in this chapter explores the following:

- the external factors related to changes in governmental rules;
- the external factors related to changes in competitive markets; and
- the internal factors related to changes in organizational culture.

External Strategic Factors Related to Governmental Rules

As described earlier, the higher education institutions in this case study were publicly funded at various levels. In 2007, the Roles and Mandates for the publicly funded higher education institutions were developed in response to recommendations from the auditor general and consultations with all stakeholders (e.g., students, employers, publicly funded higher education institutions, etc.). The Roles and Mandates outlined key directions for higher education institutions to improve their financial accountability and compliance with regulatory requirements from the government since they were publicly funded. The Roles and Mandates principles were enshrined in a modified version of the *Post-Secondary Learning Act* (2004).

In theory, publicly funded higher education institutions in Western Canada were autonomous bodies with their own independent governance structures (i.e., as per the Financial Administration Act 1985, and the Post-Secondary Learning Act 2004). However, in practice, despite the fact that higher education institutions had different balances of funding streams, they were not autonomous in that their largest contributor of funds was the government (i.e., as per the British North America Act 1867, and the Constitution Act 1867). In order to receive funding and maintain their accredited status, higher education institutions in Western Canada had to fulfill a number of regulatory requirements (Auditor General 2013, 110):

> In deciding which project it should fund the department assessed proposed projects against their program criteria and focused on whether the projects were feasible from a business and financing perspective and whether they met regulatory requirements.

These requirements included the Roles and Mandates and Letters of Expectation issued by the government (i.e., as per Roles and Mandates). First, higher education institutions in Western Canada were subject to inspection requirements related to quality standards for teaching and learning assessed by provincial quality assurance agencies (i.e., Campus Alberta Quality Council and Education Quality Assurance of British Columbia).

Second, higher education institutions in Western Canada were required to submit annual reports with financial statements independently audited (i.e., auditor general or KPMG chartered accountants as per the Auditor General Act 1985).

A public debate arose when the auditor general (2013, 49) highlighted difficulties with higher education institutions on issues related to (1) strategic planning offered by the government; and (2) financial sustainability of higher education institutions funded by the government:

- "Institutions do not clearly understand what the Minister wants (. . .) to achieve or how to achieve it (. . .). Strategic planning is missing."
- "The department and institutions have not identified sustainable funding sources for initiatives."

As such, higher education institutions in Western Canada were organizational systems with strategies influenced by external strategic changes in societal functions and rules as defined by the government (Broadbent, Laughlin, and Alvani-Starr 2010). The government used steering media in terms of regulations and provisions of funding (i.e., steering media are societal key drivers for changes that imply the use of positional power and/or incentives to initiate actions and activities at an institutional level; Broadbent, Laughlin, and Alvani-Starr 2010) to achieve specific societal goals with higher education institutions within a principal–agent relationship where the payoff from the principal (i.e., government) depended on the actions taken by the agent (i.e., higher education institutions) (Broadbent, Dietrich, and Laughlin 1996). In other words, funding from higher education institutions in Western Canada was provided under a steering media of Roles and Mandates and Letters of Expectations in exchange for funding, with only limited discretion for higher education institutions to decide whether and how the funds may be used (Broadbent, Laughlin, and Alvani-Starr 2010). However, these steering media were observed to be ineffective and inefficient in terms of the level of strategic planning and the level of funding provided by the government (Auditor General 2013).

External Strategic Factors Related to Competitive Markets

As described earlier, the higher education institutions in this case study were nonprofit, but tended to be resources constrained (Auditor General 2013, 47):

> With so many institutions, committees and entities involved and potential initiatives to undertake with limited resources, the ministry needs strategic planning and systems to carefully plan, implement, govern and sustain not only individual initiatives, but all initiatives collectively.

Funding from the government tended to be limited (e.g., in its latest 2013 budget, the government cut the operating grant to higher education institutions by an average of 6.8 percent instead of increasing it by 2 percent, which corresponded to a long-term trend for operating grants in Western Canada); hence, focus on funding from alternative and/or private sources was encouraged (e.g., summer rentals of on-campus parking and residences, corporate donations, ancillary fees, etc.). The higher education industry also sought to increase private–public partnerships (Broadbent and Laughlin 2005) (e.g., Canada-wide, Cenovus Energy's $4.4 million of Canadian Dollars endowments to chairs of Environmental Engineering and 119.4 million of Canadian Dollars record levels of gifts to Faculties of Medicine and Dentistry in 2012–2013) to partially cover capital and operating expenses deficits. The government also required that higher education institutions follow governmental economic agendas (e.g., commercialization of university-led research programs and skilled-based training with "cooperation" programs for students to integrate the workforce more effectively) and explore international strategies to increase foreign students enrolments and enrollment fee revenues (e.g., memorandums of understanding with Chinese institutions and substantially higher enrollment fees for foreign students, or funding from the Chinese government in exchange for a Confucius Institute promoting Chinese culture and language on campus).

Recently, however, a public debate surfaced to recommend that Canadian Medicine and Dentistry schools restrict the influence of the pharmaceutical industry on educational resources and course contents (i.e., half of all Canadian Medicine and Dentistry schools policies regarding public–private partnerships with the pharmaceutical industry were judged too permissive). Another public debate arose when the scientific research community criticized their muzzling by the government whom had strategically cut funding to scientific research programs that did not support the government industrial or economic agenda (e.g., oil and gas reclamation and remediation research programs and/or environmental management research programs). A further public debate concerned skilled-based training and coop programs with a call for legislation to protect vulnerable students subjected to corporations in need of a “free” workforce to decrease the cost of labor and increase profits.

As such, higher education institutions in Western Canada were nonprofit organizational systems, but they had internal strategies influenced by external strategic changes with a focus on alternative sources of revenue, private–public partnerships, and competitive markets (Broadbent and Laughlin 2005). The government has treated higher education in Western Canada like a commodity, with a focus on industrial and/or economic agendas. However, this perception as a commodity was observed to be ineffective and inefficient, as a higher education institution should be viewed as a social enterprise that contributes to the development of society as opposed to a commodity.

Internal Strategic Factors Related to Organizational Culture

The Western Canadian higher education institutions had high turnovers and termination rates for executive leaders, staff, and faculty, as well as frequent programs of “adjustments” of faculty and staffing levels with early retirement programs and severance packages. The higher education industry in Western Canada was a labor-intensive industry (i.e., more than 75 percent of operating budgets spent on salaries and benefits). Because resources tended to be constrained (Auditor General 2013), any reduction in operating and capital budgets resulted in the suspension of programs, outsourcing of service departments, suspension of maintenance projects for infrastructure, and associated job cuts.

A public debate recently arose in relation to the fact that termination of executives of higher education institutions was not financially sustainable (i.e., severance packages for executives of higher education institutions at a vice-president level and above typically involved a cost of hundreds of thousands of Canadian Dollars to the institution). In addition, local unions or faculty and staff representatives disputed job cuts and/or reopenings of collective agreements to avoid mass layoffs, arguing that there were other ways for higher education institutions to be more efficient with their spending.

As such, higher education institutions in Western Canada seemed to be organizational systems with strategies influencing internal changes in terms of their organizational culture, with less security of tenure and more fixed and/or short-term contracts, and with more focus on managerial practices (Broadbent, Dietrich, and Roberts 1997). However, this was observed to be ineffective and inefficient as the financial cost of turnover and termination was very high.

Summary

As described in this section, publicly funded higher education institutions in Western Canada were situated in a specific external and internal strategic environment in terms of governmental rules, competitive markets, and organizational culture.

This external and internal strategic environment of the higher education industry involved a shift from a collegial bottom-up model of the higher education industry toward a more administrative top-down model of the higher education industry (Broadbent, Dietrich, and Laughlin 1997) in Western Canada. This external and internal strategic environment also involved a shift from a collaborative model toward a model of principal–agent relationship and steering media. A principal–agent relationship of steering media means that the payoff from the principal (i.e., government) depended on the actions taken by the agent (i.e., higher education institutions) and that the agent only acted in ways that led to a maximum payoff in terms of operating and capital revenues (Broadbent, Dietrich, and Laughlin 1997).

This observation implied that there was a real impact of performance management systems (i.e., accounting and auditing systems) at both a societal and an institutional level (Broadbent 2011) in Western Canada, with (1) performance management systems as steering media; (2) structures of the government that controlled achievements in line with Role and Mandates and Letters of Expectations; and (3) financial stringencies (Broadbent 2011). This also meant that performance management systems (i.e., accounting and auditing systems) were powerful tools (Oakes and Berry 2009) in Western Canada, with an impact that involved instrumental obedience (i.e., with devious obedience to maximize payoff without any actual changes to interpretive schemes and actual behaviors of higher education institutions) (Oakes and Berry 2009).

The findings could be described and explained using the concepts of formal and informal management control systems (Berry, Broadbent, and Otley 2005, 13). Formal management control systems promoting clear objectives and control processes associated with specific measures of performance (e.g., governmental rules for accounting and auditing systems) were in place in the higher education industry in Western Canada. However, this top-down principal–agent model was prone to public debates, resistance, deviance, and opportunistic behavior at the informal management control systems level (i.e., resistance because of work ethics, management style, and organizational culture of executives, faculty, and staff within the higher education institutions).

Speculative Recommendations for Policy Makers

The case presented in this chapter focused on changes in the external and internal strategic environment of the higher education industry in Western Canada. This case was the basis for speculative recommendations to improve the relationship existing between policy makers and executives in the higher education institutions through formal and informal management control systems.

Regarding formal management control systems, the government needed to standardize the metrics used in the industry for most efficiency and effectiveness measures (i.e., business, academic, and financial indicators) to be identical across higher education institutions. Benchmarks already existed for some business, academic, and financial indicators in terms of efficiency and effectiveness (e.g., FTE students and operating grant per FTE student). However, most other business, academic, and financial indicators were inconsistent from one institution to the other, which made it difficult to compare institutions. Higher education institutions in Western Canada mostly reported efficiency and effectiveness indicators that "made them look good" (i.e., "devious compliance").

Regarding formal management control systems, the government also needed to redefine the business, academic, and financial indicators used to measure effectiveness and efficiency in the higher education industry of Western Canada. This redefinition of the business, academic, and financial indicators was related to the question of the role of higher education within society and the type of performance indicators and models that were important to consider given the industry's actual mission. The higher education industry was treated like a commodity with a focus on inputs (i.e., operating grants per FTE student) as opposed to outputs (e.g., "producing" employable citizens). This aspect of redefinition of the business, academic, and financial indicators was important because it was related to the position of the government in terms of the protection of the nonprofit model of higher education as opposed to its opening to the forces of the market (e.g., for-profit model).

Regarding informal management control systems, the process of standardizing and redefining the business, academic, and financial indicators for higher education needed to involve a process of open consultation, as the government ultimately was accountable to the tax payers, the same way higher education institutions were accountable to the government. The process of standardizing and redefining the business, academic, and financial indicators needed the introduction of feedback loops from the institutions to the government for "candid" communication between executives of higher education institutions and the government to be possible. Executives were key stakeholders that needed to be included in the process of standardizing and redefining business and financial indicators as the higher education industry was a complex industry to assess. The one way top-down process in place seemed to only result in some "devious compliance," resistance, and public debates. The fact that executives of higher education institutions were required to "informally lobby" with their MLAs (Member of Legislative Assembly or elected members of the Assembly of Alberta or British Columbia) as a way to interact with the government, like any other citizen, was not considered effective. The reason this aspect was considered important was that executives of multimillion Canadian Dollars institutions needed direct communication with their minister and/or deputy minister (i.e., senior civil servant in the government) to be indeed accountable as opposed to "deviously compliant" and resistant to the Roles and Mandates. Executives of higher education institutions in Western Canada needed direct and informal communication with their minister and/or deputy minister to successfully (i.e., not "deviously") implement strategy. Ministers and/or deputy ministers also needed direct and informal communication with executives of higher education institutions to understand how to measure performance in the industry appropriately.

Regarding informal management control systems, executives of higher education institutions in Western Canada also needed to be included in the strategic planning, strategy implementation, and strategy evaluation process that would be imposed on their institution via the Roles and Mandates. Indeed, if presidents were to be chief executive officers, more control over their institutions like any chief executive officer in a corporate environment, was advisable. When using formal management control systems in terms of strategic planning, strategy implementation, and strategic evaluation, the government needed to understand the value of executives' involvement to reduce "devious compliance" at the level of informal management control systems. In Western Canadian higher education institutions, strategic planning was the task of external experts from the government. Once the strategy was identified and the Roles and Mandates were provided to higher education institutions, the task of the external experts from the government was finished (Alberta Advanced Education 2007). Then, executives within the institutions had to implement the strategy in line with the Roles and Mandates (Alberta Advanced Education 2007). However, strategic management is a continuous, intermittent, and flexible process that requires continuous involvement from executives. Because of countless contingencies, executive leaders in the higher education industry in Western Canada needed to be allowed to participate in the elaboration of the Roles and Mandates in order to have more flexibility in terms of strategic planning, strategy implementation, and strategy evaluation for their institution.

Conclusions

The case study highlighted a shift from a professional collegiate model of the higher education industry to an administrative top-down model of the higher education industry in Western Canada. This shift toward the "end of a professional collegiate model in higher education" was a relatively new phenomenon in Western Canada.

The case study helped reduce an existing theory–practice divide by providing speculative practical recommendations for policy makers and executives. Speculative recommendations were related to the need for a standardized and redefined management control system to be setup by the government (i.e., level of formal management control system) and for the involvement of executives of higher education institutions in the process (i.e., level of informal management control system). This implied a constant communication process between the government and executives in higher education institutions for the benefit of both parties (i.e., expected reduction of resistance, deviance, and opportunistic behavior of executives because of consultative and participative process) and ultimately for the benefit of the taxpayers.

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Study Questions

The research in this chapter is related to the academic debates concerning internal and external changes in the strategic environment of higher education in Western Canada and the role played by Management Control Systems in the strategic alignment of higher education institutions in Western Canada. Discuss

1. Whether and how changes in the external and internal strategic environment of the higher education industry in Western Canada can be described and explained in terms of changes in governmental rules, competitive markets, and organizational culture?
2. Whether and how the strategic stance of higher education institutions in Western Canada and accounting systems are strategically aligned with a mediating role played by management control systems?
3. What speculative recommendations can be offered to policy makers, executives, and human resources practitioners?
4. What recommendations can be offered for further research to establish the descriptive and explanatory range capability of the framework?

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CHAPTER 6

Building Trust for the Internal Stakeholder—Governance Footprints within the Organization

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Abstract

This chapter uses the discussion of a case study to bring the principles of corporate governance into a conversation that would ordinarily be framed by employee organization relationship (EOR) theory. Corporate governance has traditionally focused to a large extent on responsibilities to the owners of a firm and to society. What would be the content of corporate governance directed towards other stakeholders—in this case employees? The literature addresses general corporate governance and presents for consideration the features expected in a human resource management system that functions as custodian of the governance philosophy and practices internal to an organization. An organization in Nigeria known in the hospitality industry as one with good employee practices was chosen as a subject for testing identified attributes of corporate governance. A qualitative approach was adopted since the ideas explored involve deeply qualitative constructs. The findings reveal that the case organization is people-focused with high levels of trust and commitment among the workforce, confirming our initial propositions.

The organization appears to have been able to establish a virtuous cycle of trust and governance with regard to their internal stakeholders. However, documented policies need to be adopted in order to strengthen and sustain the inclusive organizational culture observed. The efficiency of the human resource function could be very important for ensuring that EOR practices align with and support the corporate governance principles that the organization wishes to imbibe.

Keywords: Internal governance, employee management, hotel management, hotel HRM, ethical HRM, Nigeria, inclusive management.

Introduction: Governance within the Organization

Literature on corporate governance has usually focused on two stakeholders—the owners and society. Stakeholder theory, however, includes other stakeholders. What would be the content of corporate governance that is directed toward employees? This qualitative study brings the principles of corporate governance into a conversation that would ordinarily be framed by employee–organization relationship (EOR) theory.

The case chosen is one in which the organization appears to have, perhaps unintentionally, combined the unitarist and pluralist human resource (HR) management paradigms to get the best of both worlds due to an emphasis on doing what is fair toward their employees. The organization succeeds in harmonizing the staff's goals into a single purpose and at the same time acknowledges and respects the individual perspectives of employees as human beings worthy of that dignity. They try to be ethical and fair toward them and this paves the way for an establishment in which the employees flourish due to the eminently humanistic approach to achieving internal governance, and their interests are considered without need of recourse to unions.

The chapter begins by briefly discussing some literature on corporate governance and making some propositions about the features expected in a HR management system that functions as custodian of governance philosophy and practices internal to the organization. Then, using the qualitative case study method, the authors present an example of a real organization and then discuss and draw conclusions therefrom.

Governance, HR, and Internal Stakeholders

To start with, what is corporate governance? One stream of scholars speaks of corporate governance only in terms of protecting the interests of shareholders, while another extends the protection to the interests of all stakeholders (Agamah 2013). It seems more in consonance with a business ethics and corporate responsibility perspective to include all stakeholders in one's purview when involved in a discourse on corporate governance. According to Bandsuch, Pate, and Thies (2008), "Corporate governance (CG) refers to the variety of principles and practices that direct the core processes and relationships of a business. More specifically, CG reflects the formalized values and procedures implemented by the business's recognized authority (e.g., owners, directors, and managers) in its various operations and interactions with stakeholders."

Stakeholder theory acknowledges some major stakeholders who have interests in the organization. Although different scholars include different groups among such stakeholders, practically all of them include customers, employees, owners or shareholders, suppliers, and society (Donaldson and Preston 1995; Jensen 2002; Roberts 1992). Just as shareholders are represented by management that decides their future with regard to their stake in the business, so also employees are often represented by a management who decides their future with regard to their stake in the business. Trust in the business is essential for each of the stakeholders; otherwise, the transaction costs of business would go up in each direction. While in the case of shareholders, especially potential shareholders, it would translate into a higher cost of capital, in the case of the workforce, it would also translate into a higher cost of human capital—turnover, lack of commitment, lack of satisfaction, absenteeism, presenteeism, aggression, unethical behavior, and so on. For the performance of the company to remain steady and to grow, it is just as important to build trust within as it is without. Moreover, an organization that wishes its employees to be ethical needs to start by being ethical in the way it relates with them, recognizing their human dignity and respecting them. Within the EOR, there is a need for responsible organizations to ensure that they act in ways that favor employee flourishing.

Thus, combining stakeholder theory with theories of corporate governance and EOR gives us an additional platform from which to encourage organizations to be responsible employers of labor by having regard to the human flourishing of their staff.

Having in mind the HR department as a representation for employees to the extent that employee grievances go to them, we can approximate the function of a board of directors as shareholder interest representation to the function of HR as employee interest representation. It is a limited parallelism, since HR units are notorious for degenerating into personnel units or even worse into guard dogs for the organization rather than functioning as an employee-concern-oriented unit. However, the alternative representative body for employee interests—unions—is not the ideal one in every situation since it is traditionally placed outside the immediate stakeholder framework. Its ability to represent employees in the stakeholder dialogue may, therefore, be limited to a reactive and external role. HR departments and systems are within the organization, and one must acknowledge that despite the inherent conflicts in their responsibilities (Renwick 2003; Harris 2008), HR professionals are more and more seeing clearly that an aspect of their role is to be employee champions (Ulrich 1997; Francis and Keegan 2006).

Their ability to carry out this role, without being in as independent a position as unions are in, will depend on their credibility among the employees of the organization, which will in turn depend on the culture within the organization and proof that they indeed understand and embrace the demands of such a role. For example, an HR department that historically champions employee causes,[1] promotes employees' interests even before they themselves point these out, and objectively assesses employee claims would have much more credibility as a representative of employees' well-being within the company than one that historically acts as watchdog for the organization and always takes the side of the organization against the employees even when doing this is not equitable.

In other words, despite the fact that HR units exist within the organization and are provided for by it and so may seem indeed to be

[1]While maximizing still employee commitment as expected of the dual nature of the HR role.

predisposed to be biased, they can actually act as some kind of referee between the organization and its employees, in much the same way as the board of directors acts as a referee between the shareholders (of whom they constitute a part) and the management team (of which some of them usually constitute a part). Granted that the analogy is not without many limitations deriving from HR's multiple and at times conflicting roles, we believe it is still a useful lens to bring to bear on EOR theory and practice, especially for entrepreneurs in emerging economies who wish to run responsible organizations and attract talented staff by embracing best practices of more established organizations.

There must, however, be some ideas guiding an HR department that wishes to carry out its role to mediate on behalf of employees and build their trust on behalf of management and the other stakeholders.

According to Bandsuch, Pate, and Thies (2008), the essential factors for establishing corporate governance include the following:

1. principle-centered leadership;
2. transparency;
3. stakeholder voice; and
4. ethical culture.

Lipman (2007) divided corporate governance principles into three broad categories—those to do with board structure, those to do with board operations, and others. This is one way of looking after the interests of stakeholders. However, it would appear that this is a control approach for establishing good governance, essential but perhaps incomplete. We believe, together with Lynne Sharpe Paine, that establishing ethical culture should be done both from a compliance perspective and from an integrity perspective, and this will serve the purpose of governance more effectively.

Thus, we propose to categories internal corporate governance into four broad categories following Bandsuch, Pate, and Thies (2008), and we expect to find people systems that inhibit or enable an ethical climate along these lines within organizations. HR governance policies and practice would need to be crafted to support each one of the four categories, e.g., provision of staff handbooks, and procedures within the organization.

With the foregoing in mind, we make the following propositions:

1. An organization with strong internal governance philosophy and practice is likely to acknowledge employees as important stakeholder in its business and to ensure that they have some form of representation—either through a formal or informal HR function.
2. An organization with strong internal governance philosophy and practice is likely to respect employees' dignity and to find ways to show it, e.g., by establishing an enabling work environment for employees.
3. An organization with strong internal governance philosophy and practice is likely to have an independent way for employees to be heard—their suggestions, complaints, and so on.
4. An organization with strong internal governance philosophy and practice is likely to have an HR outlook that champions employee causes and protects their interests and flourishing.
5. An organization that does all the aforementioned is likely to attain high trust levels among their workforce.

Methodology

This study was conceived as qualitative research using the case study method. Since the ideas involve deeply qualitative constructs, it was felt that a case study approach would best test for their applicability in practice to organizations. Hence, a real organization was selected, for convenience, in order to check for preliminary confirmation or rebuttal of the propositions derived earlier. The organization chosen was one that is anecdotally famed for good employee practices. It was, therefore, felt that this would be a good subject for testing for the attributes of corporate governance proposed.

Case Study: A Lagos Boutique Hotel

Overview

The Beaver[2] is an 80-room boutique hotel located in Lagos, the commercial capital of Nigeria. Following a dominant model in the hotel sector in Nigeria, The Beaver is owned by a Nigerian investor and is operated

[2]Real name withheld.

under management contract with a foreign hotel management company. The facilities include a 200-capacity conference room, several meeting rooms, a fine-dining a la carte restaurant, a casual deli restaurant, and leisure facilities such as a swimming pool, gym, and sauna.

Sullivan, an expatriate, is the general manager (GM) and has worked with the management company for over 15 years. He entered the market with them for the preopening of The Beaver and remained with the hotel to date. Having worked his way up in the industry from switchboard to senior management, Sullivan is singular in his belief that employees form the basis of the success or failure of a business: “If you take care of your people, everything else will fall into place.”

Opened barely two years ago, The Beaver has received good ratings from online customer-generated review websites as the property with the best service culture in Lagos; this is a position it has held consistently over its two years in operation. This case study presents underlying principles that guide Sullivan in his mission to deliver excellent service with a team of people who are passionate about what they do.

Staffing

With 200 full-time employees—15 percent in managerial positions and 85 percent in supervisory and operative positions, the property operates over and above the industry staff to room ratio with 3.07 staff to a room. The reason for this was primarily driven by the stakeholders’ desire to make a statement by delivering standards that would differentiate them from other market players. “If a room attendant is going to clean a room, then let him clean the room well. Better to get three rooms done very well than eight rooms done badly.”

Pay

It is a known fact that labor costs in Nigeria are low and so this provided the management of The Beaver with an opportunity to employ more hands. Statutory requirements under the employment laws of Nigeria include paid holidays, up to six months paid maternity leave, contributions to health insurance, pension schemes, and an industrial training fund.

In addition to the statutory provisions, employee remuneration at The Beaver is above industry average:

> By way of an example, for every take-home package of $300, the Beaver supplements this by providing an additional $300 worth of perks such as transportation to and from work, good staff meals, laundry services for uniforms, overtime pay for staff on night shift, regular training opportunities. In addition, over 70 percent of the service charge is paid out to staff, which could in some months add up to another $300.

Turnover

New hotel developments in Nigeria have doubled in the last five years, with even more openings billed for the coming months (Adepoju 2014). This increase has led to an increase in the demand for staff in these properties. A characteristic feature of employment market dynamics that has arisen therefore is that of a highly mobile workforce. As new properties open, staff from existing properties leave to take on positions in these new hotels. Turnover in some properties average 40–50 percent in one year and especially when there is a preopening of an international chain hotel. Turnover statistics at The Beaver have averaged out at 4 percent since the opening two years ago. This figure represents the total number of voluntary resignations and dismissals. This is an astonishingly low figure considering that a 600-room international chain opened its doors last year. How was the potential threat of losing key employees addressed?

> We work as a family here. I operate an open door policy where any employee is able to come up to me and tell me things. We have a general meeting every month (apart from the departmental meetings) where everyone comes together to listen and to speak. I get 50 percent of the truth but at least it gives me a true sense of what their needs are. When we knew that the pre-opening of the large property was imminent, we called a meeting. And I told them the facts. "I know some of you will leave, but have you asked yourself some questions before you do that? Will you be paid on

> time? Who are the owners? When it comes to being paid, the brand won't help you, it is those who own the pockets. When we opened, we told you that we won't be able to pay you the service charge until after six months. Will they pay you your service charge after six months like we did? Remember that hotels over-recruit for openings and then shed when operations settle down. Remember all this when you make your decision."

Thereafter, The Beaver lost four employees—three waiters and a newly appointed executive housekeeper. Less than three months after the pre-opening of the new hotel, the waiters were in contact with Sullivan asking to be taken back to work with The Beaver:

> People need to be guided to make decisions that affect the long term and not just the next few weeks. We need to train people to think of developing careers and not just jobs. In two years of our opening, there have been promotions from operative to supervisory and managerial positions. There must be a development plan for employees. They have to see the plans for succession available within the organization. We help them with their career plans. Once a year we conduct appraisals, each employee over an hour and 40 minutes with me. You have got to show people that you mean business. What did we plan last year at the appraisal? Where are you now? Have we delivered in helping you achieve your goals? What you can't do is bluff. People need to see that you care for them.

Communication

Sullivan's approach to open communication has helped him to demand loyalty from his team:

> At the general meeting, we ask questions regarding the quality of staff meals, their jobs, their concerns and more. What we also do is to present them with the plans for the hotel. We tell them about the progress of the hotel and how this will impact their jobs. Information sharing is critical if employees are to buy into

> the picture. It is important not to promise what I cannot deliver. The element of trust is an essential ingredient here. I realize that with what I tell them in August, I'll need to stand before them again in September with the facts. That helps a lot to focus. I tell them, "if you tell me the truth, I will be your biggest defender. I will help you when you make a mistake. But if I find out that you hid something from me and it ends up embarrassing the company, or me it won't go easy for you. People should not be afraid to say when they have made a mistake."

Zero Tolerance

A key policy of the hotel management company is that of zero tolerance for unethical behavior from any quarter, be it owners, customers, or employees:

> I think this is a very honest company aligned to my principles and values. For my part, I think that I have been blessed with a company that supports you and encourages you to succeed. Quite understandably, an investor who has pumped in millions of dollars in a business is determined to see it succeed. This is the genesis of the model of an owner's representative sitting in to "watch over operations." This is the source of many tensions. In just three years of opening, an international chain in Lagos has had five general managers. Do you know what this does for operational continuity? Our shareholder strongly believes in the value that a management company brings to the table. Working with the minimum interference has worked for me and the hotel. Profits have been good, so I hope it stays that way!

It is policy at The Beaver for room service associates to leave the door open when serving a guest who might be in a compromising position.

> It means a lot to them that they do not have to sacrifice their dignity to keep a job. On some occasions I have had to ask guests to

> check out because of the way they treated my employees. Being of service is not the same as being subservient. I try to teach each one of them that we all need to be respected professionals and so we must be treated and addressed as such. What you do, do well. Develop a culture of pride in your work . . . without being snooty about it.

There is also zero tolerance for mediocrity comes to our guest service:

> Given, there are many environmental challenges out there that could provide a perfect excuse. Some of my employees spend four hours in traffic to get to work. But I ask them to leave all that at the gate when they come in. If you work with the mindset that it is beyond my control, and then there are many reasons not to strive for excellence. The government is at fault, the roads are bad, and there is no power. Valid reasons but which cannot justify mediocrity.

Discipline and Fair Hearing

There is a clear disciplinary code and grievance procedures are consistently and fairly applied. People are thus made aware of what constitutes acceptable and unacceptable behavior. When there is a problem, the employee is offered an opportunity to correct the problem. It is only when this approach fails that the option to terminate the employment relationship can be considered:

> There was a case of a manager who was found carrying out sharp practices in the front office. It was a case of whistleblowing—another employee informed me about what was going on. It did not matter that the person reporting was junior to the person being reported. In fairness to the accused man, a detailed investigation was carried out, giving him the full benefit of the doubt. When the allegation was found to be through, he was let go.

Job Satisfaction

Are people happy with their jobs at the Beaver?

> I don't know. But they are content. Salaries are paid on time with no excuses. We spend over $18,000 a month on providing safe transportation. We have staff loan facilities that cater for all forms of contingencies. The extended family system is very strong in this environment and it is not surprising that people are called in to support family and friends at weddings, births and funerals. We find that offering this support goes a long way in creating a bond of loyalty. For some, I have to say that I don't think we can make you happy. You are not prisoners here, if you feel you have to go then do not feel trapped, go with our blessings.

Training

Constant training is critical for achieving any form of results in the business of hospitality:

> West Africa has not traditionally been a hospitality destination like the East, South, and North of Africa. As a result, many Nigerians are not accustomed to the hospitality culture. Hiring outside West Africa is a lot easier when it comes to finding skilled people. HR polices focus more on induction procedures. Here in Nigeria, we have to hire attitude and character because there is very little formalized experience in the job market. To move from a blank slate to fully trained requires a minimum of six months if you want to do it right. At The Beaver we train all employees at least once a month, no matter how small. For some who have requested, we offer cross-training in other departments, but this is not always possible.

Unions

With regard to the employee unions that exist in a number of hotels in Lagos:

> We have never been approached by the union. I guess this proves that we don't need them. I believe exploitation leads to unions.

They are necessary in some environments but not in ours. If people feel that the general manager is someone I can talk to and who listens to me, then I don't need a mediator to fight for me. I work with very intelligent people who are always looking for a way to get ahead. Nigerians are passionate about going forward. This is a double-edged sword sometimes. But I have experienced an intense mental agility to succeed. And that is a good thing. I tell my employees that "the success of The Beaver is your passport to success." When you leave, think about the advantage of having worked for a great hotel on you CV. Have fun in the workplace; develop a sense of humor when things get tough. We work 14 hours together, we should be able to get a laugh sometimes.

In conclusion, Sullivan believes that a GM should not stay too long in the same place:

After four years, you begin to get used to things and become less passionate. An expatriate should transfer skills to the people who work with him. The aim should be to help the people develop and take over these positions. It does not make sense to sit on information in order to keep the position for you, which is wrong. I want to leave a legacy behind. That a place is still standing even when I am gone—that is a legacy.

Discussion

The nature of the hospitality business sector (hotels in general) is such that it is characterized by a transient workforce who moves from one establishment to another in search of more equitable conditions. From irregular to nonpayment of service charges and overtime duties, informal employment procedures, and so on, employer practices could easily be unethical, especially toward less highly skilled staff. Thus, it is only to be expected that the responsibilities of HR units toward the employees in their care could be graver. Granted that unions have a role to play in representing employees but, as already mentioned earlier, their contribution is often after the fact, in reaction. True governance should be proactive as well as reactive. In the case of employees, the HR structure can provide the internal buffer to protect them in advance of possible problems within the system. It appears that the owners and management of The Beaver have established certain standards of ethics toward employees that enable the HR function to be employee oriented. Their approach may not work with every organization, but it is one valid example of what type of best practice could be adopted in this industry and indeed in EOR.

Ownership Distance

At The Beaver, the owners have a clear strategy of noninvolvement in the running of the business this is a rarity with Nigerian investors—at least in the hotel sector. Thus, the owners and their families pay for any services they use from the hotel. The dreaded "charged to the owner's account" that is the bane of other industry players does not exist at The Beaver. The reference made by Sullivan about a much bigger competitor—part of an international chain of hotels—that has gone through five GMs within 3 years is a case in point, as this was apparently due to issues of owner's interference. The practice of manager–owner independence at The Beaver appears to contribute to fostering a mutually beneficial relationship. It is more the exception than the norm in the industry, but it is a practice that future entrepreneurs can learn from.

Principle-centered Leadership

People need to see "that you mean business" and "people need to see that you care for them." Seeing that there is good governance (for example, internal control and transparency; sobriety in executive remuneration; and obedience to national and industry law and regulations according to Adewale 2013) at the level of leadership is a spur to employees to trust in the integrity of management. Among others, these are two principles guiding the leadership of The Beaver as exemplified in Sullivan. These principles run through the interview and are consistent with their belief that "If you take care of your people, everything else will fall into place." Sullivan goes so far as to hold himself accountable to his employees. The fact that Sullivan has an open meeting where people can express their thoughts freely is indicative of the respect he has for their opinions. In addition, the high level of employee commitment[3] and low employee turnover rate at The Beaver are a sign that there is more than tokenism at work here. The interactions with two current employees also confirmed that they believe Sullivan is a man of his word and cares about them; they are extremely happy to work with him.

Transparency

Employees know the plans of the company and have information about the progress made regarding those plans. This promotes a sense of ownership and of responsibility. The succession planning within the organization also appears to be a transparent process. This engenders trust and openness. With regard to their personal decisions, the employees are given information and left in freedom. The transparency makes it easier to demand transparency in return.

Stakeholder Voice

Employees are critical to organizational success; as Sullivan says, at The Beaver, employees have multiple opportunities to speak—meetings, open door policy, and departmental meetings. In their appraisal conversations, they are expected to say if the company has not helped them to achieve their set goals. Thus, the company presents itself as open to criticism. Sullivan's climb to senior management from the switchboard sends a message to other employees about the trust that the organization has in them.

Ethical Culture

The company itself needs to model the respectful culture of fairness that they expect from employees. Fair pay is one of the winning cards at The Beaver: "salaries are paid on time with no excuses." They also make sure that they abide by the law with regard to leave periods, allowances, and so on. Adequate staffing in order to deliver the expected quality of service is also a way to show respect for employees and contributes to their having

[3]Evidence from employee feedback including interns and levels of guest satisfaction reported on www.tripadvisor.com.

stress-free working conditions that allow them to flourish as humans. Customers are held to the same standard, and employees are protected from customer misbehavior, as is clear from some of their policies. The organization backs them up. In return, the company is able to demand what they term as "zero tolerance for unethical behavior." This includes being "respected professionals" who work well and give their best at The Beaver for the period that they remain with the organization.

Another way to treat employees as befits their dignity as humans is to develop them. The Beaver's approach to this is to develop people for their careers rather than for the jobs they do in the organization. They make sure that there is "a development plan for employees." Training is carried out first in order to supply the "formalized experience" that some employees lack and then also to enhance their skills.

Employee Trust

Practicing the principles of corporate governance as discussed earlier leads to increased employee trust. According to Sullivan, "exploitation leads to unions." A negative perception of unions is not uncommon; they are often seen as catalysts of conflict of employees with organizations. To the extent that one has this view of unions, it is understandable that where organizations have been proactive in establishing good relationships with their employees and their employees trust them, they will not need an extra stakeholder (unions) to represent their interests. They will be able to rely on an internal organ to offer this service—the HR function. In The Beaver, as already noted, the HR function is synonymous with management, yet this does not constitute a problem. On the contrary, "people feel that the general manager is someone I can talk to and who listens to me," so they do not need "mediators" to "fight."

The employees at The Beaver are not passive. They are ambitious folks. The management at The Beaver needed to align staff interests to the organization's interests and were able to show that to staff—"the success of The Beaver is your passport to success." This is reinforced by a culture that encourages the transfer of knowledge and skills, as is expected in an organization in which there is trust (McEvily, Perrone and Zaheer 2003). Developing people is one of the sure ways to win their commitment. It

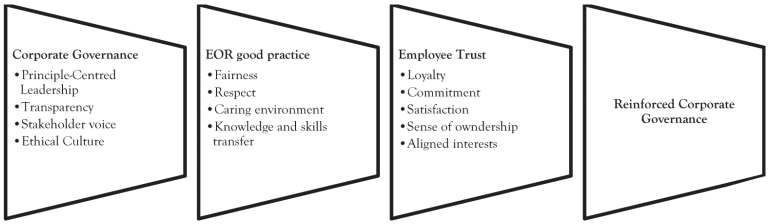

Figure 6.1 Virtuous cycle of trust and governance at The Beaver

shows them that there is trust in their ability to grow with the organization and take on more responsibility. If this is the general organizational culture, then lateral and vertical knowledge and information transfer also proceeds smoothly, such that transparency becomes a culture and further enables trust. Thus, a virtuous cycle is established that tends to reinforce the levels of corporate governance in the organization, as shown in Figure 6.1.

This case is an example of an organization that has succeeded in establishing a loyal workforce who believes in management and trusts that their interests are served. The organization therefore enjoys the many benefits of trust as outlined by Kramer (1999). The humanistic proemployee approach by the GM of The Beaver is a personal guiding principle of the manager himself and he has driven it into the culture of the organization. The HR structure is informal; since it is a relatively small business, the HR department is the owner management. The Beaver experience proves that if employees are fairly represented within the company, there will not necessarily be need for them to be represented by unions. Similarly, they do not need "an owner's representative sitting in to 'watch over operations.'" Where there is no trust, there is tension, and tension does not make for a healthy work environment.

A few notes could be added here about the context in which The Beaver is operating. The Nigerian hospitality industry is one in which "expatriate recruitment" is considered the default line of action if one is to sustain a certain level of service delivery. The most common reasons cited relate to a skill and work ethic deficit in the local market. This informs the leadership style adopted by many expat GMs when they are recruited and eventually work in Nigerian enterprises. It could easily breed contempt on the part of the GM and a reaction of resentment on the part of the other employees if not handled with sensitivity. Concrete cultural issues that exist in the Nigerian workplace include an almost servile deference to authority, respect for the elderly and the extended family unit manifest in such a way that the decisions of those in authority are challenged with great difficulty on the part of team members, and family issues are brought to the fore in the work environment with contributions made by anyone within listening range, and so on. Management executives have to know how to bring out the best in their staff—getting them to innovate and take ownership and yet harnessing everyone's contribution for the good of the firm; being concerned about them and their challenges; and yet drawing the line between work and family problems. Naturally, it helps if the staff see a similar pattern in the leadership—that family does not overly intrude to the detriment of business and that personal initiative is appreciated and respected even when it appears to challenge the opinion of the "boss." This is another aspect where the independence of The Beaver management from the owners could be helpful: once the GM is appointed, he or she takes on the full responsibility of making the business run and earning the respect and affection of his or her staff in order that they work together.

Conclusions

Confirming our propositions,

1. The Beaver acknowledges employees as important stakeholder in its business, though their representation (HR) is a small one and not totally separate from the management function—there is an HR department with an HR manager and an assistant. In order to establish the present good practices and ensure consistency in them, it would be useful that they are documented fully and reside in a distinct role that undertakes the HR function. Documentation would help to guard against their being affected by individual preferences and idiosyncrasies as could occur, for example, if Sullivan were to move to another role and a replacement to succeed him. Residing in a distinct role would mean that, as documented policies can also be changed by a replacement, this approach to employee orientation would be adopted at the level of those with power to recruit GMs. It could be promoted and publicized as "The Beaver Way" of doing business.

This would help to strengthen it as the foundation of an inclusive organizational culture that will continue regardless of the GM in place.

2. The Beaver respects and defends employees' dignity and shows it by being loyal to them with regard to customers who misbehave, helping them to take pride in their work, and so on.
3. The Beaver hears employees through a number of media—meetings, appraisals, and so on and tries to attend to their issues with fairness and promptness.
4. The Beaver appears to be people focused and takes steps to promote their employees' careers as well as take an interest in helping to resolve their legitimate personal and family problems.
5. The Beaver appears to attain high trust levels and commitment among their workforce, manifested in their low turnover in a high mobility job market.

In summary, a lot depends on the way people are treated within the organization and the level of trust that is established. Speaking more technically, we could point toward the need to ensure the efficiency of the HR function (formally or informally) in order to ensure that EOR practices align with and support the corporate governance principles that the company is trying to imbibe in order to be a responsible business entity.[4]

Future research can also consider the degree of independence that HR departments enjoy in order to do their work and the factors that can facilitate this independence. They wear two caps, as in the case of a CEO who is also chairman of the Board,[5] and they need to find ways to act in each capacity without prejudice to the double interests they represent. To carry the analogy further, future research should consider whether it is useful for good governance and for the practice of management for employees to have independent representation in the decisions that affect them. Also of

[4]As envisaged by the principles for responsible management education published by UNGC in 2007, those who are going to work in business in future need to be educated regarding the best practices expected of responsible organizations.

[5]Following numerous scandals in Nigeria and abroad, the Code of Corporate Governance in Nigeria was drafted to include a recommendation that the CEO position should be separated from the board chairman position except in cases where a strong nonexecutive independent director serves as vice-chairman.

interest would be research into the extent to which an organization can remain as flexible as it needs to be, such that practices reflecting entrenched principles of governance can be adapted or adopted when needed, without too great a resistance to change from the staff of the organization.

Authors' Biographies

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Since 1998 she has specialized in developing manpower within the hospitality industry in Nigeria and the United Kingdom particularly in skills training centers. Her key competencies are in workforce-based research, curriculum development, training needs assessments and delivery. Her experience includes advising and delivering training solutions to numerous hospitality organizations in the accommodation and foodservice sectors. She has been actively involved in the hospitality conference circuit in the United Kingdom, Croatia, Switzerland and the United Arab Emirates.

Belinda is a fellow of the Institute of Hospitality, UK, the professional body for individual managers and aspiring managers working and studying in the hospitality, leisure and tourism (HLT) industry, and also the Area Consultant for West Africa on the Board of the European Council on Hotel, Restaurant & Institutional Education, the official federation for Europe, the Mediterranean Basin and Africa of International CHRIE, the leading international organization that supports education and training for the world's largest industry.

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Study Questions

1. What governance issues would you expect to arise in a cross-culturally managed hotel such as The Beaver?
2. What would be your expectations of an HR department if there was a threat to staff's interests? How could these be reconciled with the responsibilities of HR professionals to the organizations as staff themselves?
3. What checks and balances should be put in place to ensure that power is not abused within an organization, especially with regard to how people are treated?
4. Which policies at The Beaver have the greatest potential for generating employee loyalty? Why is this so?
5. How does Sullivan's understanding of service culture impact on his management style?
6. In what ways could one demonstrate the impact of ethical corporate governance, internal to the organization, on bottom-line performance?

CHAPTER 7

Corporate Governance and Voluntary Disclosure: A Study on the Banking Industry of Kazakhstan

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Abstract

This study aims at investigating the extent and determinants of voluntary disclosures and their relationship with the corporate governance (CG) aspects of banking companies in Kazakhstan. The empirical results suggest that the number of outside directors has significant positive impact on a disclosure score. Increase in bank size also leads to a higher degree of voluntary reporting. However, our findings indicate that those voluntary reporting practices did not improve over time. This study has some policy implications. First, it adds to the existing literature on voluntary disclosure and CG practices in an emerging economy context. Second, it can help policy makers bring about the necessary changes in future CG and reporting systems of the country. However, as the study was limited to one industry, and therefore, generalization of the findings may not be applicable to other industries.

Keywords: Corporate governance, social responsibility, stakeholder management, voluntary disclosure, environmental reporting.

Introduction

Transparency, accountability, and good governance have become imperatives for publicly listed companies after the recent accounting scandals and financial debacles (Adelopo 2011; Cormier, Ledoux, Magnan, and Aerts 2010; Miller, Eldomiaty, Choi, and Hilton 2005; Ross and Crossan 2012). Companies now need to disclose obligatory as well as nonobligatory financial and nonfinancial information to the stakeholders who will be affected or may be interested in their decisions (Sobhani, Amran, and Zainuddin 2009). For a good corporate citizenship image, companies should construct reporting systems in understandable forms and media and should make them freely available and directly accessible to all concerned parties (Nurunnabi and Hossain 2012). The disclosure of all relevant information in the annual reports of companies' remains a norm in this regard (Aljifri 2008; Monterio and Guzman 2010). However, the quality of information provided by corporate companies in their annual reports has attracted considerable interest among scholars, regulators, and market participants, and companies face immense challenges to meet the increased demand for transparency and good governance (Arcay and Vazquez 2005; Crawford and Williams 2010).

Corporate disclosure plays a crucial role in mitigating information asymmetry and reducing agency problems (Cormier et al. 2010). In particular, by releasing both mandatory and voluntary information to the capital market, companies can lower their capital costs, gain investor confidence, and improve marketability of shares (Carnevale, Mazzuca, and Venturini 2012; Kristandl and Bontis 2007; Mahadeo, Hanuman, and Soobaroyen 2011). Einhorn (2005) provided a model that indicates that a firm's voluntary disclosure strategy is significantly affected by mandatory disclosure requirements in its home country. Vurro and Perrini (2011) concluded that disclosing more voluntary information to reduce information asymmetry can reduce a firm's cost of capital. In studies dealing with changes in disclosure levels, Barako, Hancock, and Izan (2006) identified that firms with more detailed voluntary disclosures provide more accurate and less dispersed analyst earnings forecasts. In addition, Arcay and Vazquez (2005) found that firms increasing their voluntary disclosures lower their bid-ask spreads, a measure of cost related to information asymmetry. Haniffa and Cooke (2002) documented a negative relation between voluntary disclosures in annual reports and the cost of equity for firms.

Although numerous empirical and analytical studies have been conducted on voluntary disclosures both in developed countries and emerging markets, there is no such study on Kazakhstan. In this study, we first assess the extent of total voluntary disclosure and its categories in financial and nonfinancial reports of banking companies listed on the Kazakhstan Stock Exchange (KASE). Second, we provide the empirical results of the association between voluntary disclosure practices in Kazakhstan's banking sector and specific characteristics of the banks. Our study contributes to the existing corporate governance (CG) and disclosure literature and can help both policy makers and academicians in future decision making.

Research Context: Voluntary Disclosure and Corporate Governance Practices in Kazakhstan

Over the last several years, most Asian economies have been actively advancing their regulatory framework, especially in terms of CG, transparency, and corporate disclosure (Welford 2007). In this regard, Kazakhstan is not an exception (Tyrrall, Woodward, and Rakhimbekova 2007). To improve CG practices of the private-sector organizations, the Government of Kazakhstan developed a Code of Corporate Governance 2005 and declared it mandatory to joint stock companies (JSCs) to follow the guidelines stipulated in the Code of Corporate Governance. In addition to developing a code of CG for the private-sector organizations, the government also instructed all the JSCs to follow some specific reporting and disclosure practices. The JSCs are required to include major transactions in their annual report and publish the annual reports in mass media. They are also required disclosing information related to shares and stocks, major and interested-party transactions, property pledge exceeding five percent of total assets, and participation in other company shareholdings. In addition to annual reporting practices, JSCs also required to submit periodical reports to the National Bank on a semiannual basis. These mandatory requirements have improved the CG and financial reporting practices in Kazakhstan substantially in recent years. However, for further improvement of accountability and transparency, the business organizations need to disclose more information voluntarily to different stakeholders. Voluntary disclosure will enhance the image of the companies in the public sphere and will help Kazakhstan to achieve "Kazakhstan 2030" goals and objectives.

In fact, the accounting system of Kazakhstan has its roots in the former "Soviet plan/chart-based system" (Tyrrall et al. 2007, 87), which simply aimed at controlling and operation of key organizational resources and helping to facilitate monitoring process for the top management, that is, it is mainly a "compliance-based approach" (IMF 2009). The system emphasized on adopting rules-based and standardized information processing practices across the industries and sectors of the economy (Kalyuzhnova and Nygaard 2008). Evidently, in recent years, Kazakhstan made significant progress in its financial reporting system. Most of the large business organizations now adopt the International Financial Reporting Systems (IFRS) or U.S. the Generally Accepted Accounting Principles (GAAP) accounting standards (Fitch 2009). However, the state Financial Supervision Agency (FSA) does not have enough authority, legal protection, independence, and resources to enforce all the financial reporting systems and take corrective actions when required (IMF 2009).

Despite adaption of CG code of practices, in the area of board responsibilities, disclosure, and transparency, accounting and financial reporting systems remain vague and unclear, and most of the managers find a huge gap and lacking in good governance practices (Johannesson, Palona, Guillen, and Fock 2012). Experts view the adoption of the CG code as a mere formality for companies. The code exists only in company policy documents and does not affect real business practices (Babenov 2010). The development of the country's stock market, that is, KASE, is very slow, and most of the transactions still occur over the counter, and therefore, financial reporting does not bear any significance to investors (Tyrrall et al. 2007). However, as the government is planning to activate KASE by floating new initial public offerings (IPOs) in 2012, and banking companies are now trying to get international credit ratings, disclosure of important financial and nonfinancial information to the stakeholders and prospective investors has become an important issue for business organizations in Kazakhstan. This study can help to fill the vacuum in this area for those stakeholders.

Literature Review: Theoretical Background and Hypotheses Development

The objective of corporate disclosure is to provide useful and relevant information in an easily understandable and freely accessible manner to stakeholders and all other concerned parties (Crawford and Williams 2010; Fifka 2011). However, the extent and coverage of such disclosures appear to vary from company to company within a country, or even within a particular sector or industry (Adelopo 2011; Haniffa and Cooke 2002; Okpara 2011). Researchers have tried to find out the reasons for such variations, and have explained the differentiated practices from different theoretical perspectives.

The agency theory postulates that managers, as agents of the shareholders, should disclose all relevant information in their annual reports, since the shareholders cannot oversee routine corporate activities (Jensen and Meckling 1976; Fama and Jensen 1983). For ordinary shareholders, demanding detailed information through annual reports is as a means to control the behavior of managers within their pre-specified corporate mission, goals, and objectives (Mahadeo et al. 2011). If the managers do not disclose sufficient information in their annual reports, the shareholders can engage intermediaries such as analysts and rating agencies to uncover all missing information (Laidroo 2009). Therefore, by disclosing all regulatory as well as voluntary information, the managers of firms can reduce their agency costs and be considered trustworthy to the shareholders (Gaa 2010; Miller et al. 2005). The stakeholder theory also suggests that stakeholders have the right to all information about the corporations, as it impacts them. So, organizations should voluntarily disclose mandatory and non-mandatory information as much as possible. This will develop their corporate image and bring about benefits in the long run. However, in publicly listed companies, the board of directors, as the nominee of ordinary shareholders, usually take all the strategic decisions of the company and, therefore, direct the managers to prepare annual reports and all other relevant documents for the ordinary shareholders and external stakeholders (Donnelly and Mulcahy 2008; Gaa 2010).

So, from both the agency theory and the stakeholder theory perspectives, the board of directors control and monitor the opportunistic behavior of managers (Jensen and Meckling 1976; Steurer 2006), and therefore, the number and composition of board directors have a significant influence on corporate voluntary disclosures (Hidalgo, Garcia-Meca, and Martinez 2010). The composition of inside and outside directors could be a determinant of voluntary disclosure practices. As expected, outside directors do not have any financial interest and they are less involved to routine interaction with the managers. Therefore, they are supposed to be neutral and unbiased in the decision-making process. Outside directors are normally selected with diverse industry background to bring additional expertise and new ideas in the board meetings (Fama and Jensen 1983; Kolk and Pinkse 2010). They are also more cautious about their personal as well as own organizational reputation. Protecting the ordinary shareholders interest as mandated by the nominating authorities could serve moral pressures on them, and subsequently, they will be more interested for voluntary disclosures. Therefore, pressures from the outside directors can have an impact on disclosure policies and they could be forced to disclose more information in the publically available domains (Hidalgo et al. 2010; Mitton 2002). The JSCs Act, 2003 requires public-limited companies to select at least one-third of board of directors members from the independent directors (i.e., outside directors) and form at least four committees to oversee decisions related to strategic planning, personnel and compensation, internal auditing, and social aspects of the companies. This measure is supposed to have positive impact on voluntary disclosure practices of banking companies in Kazakhstan.

H1.1: There is a positive correlation between the extent of voluntary disclosure in the annual reports and the number of directors of the banking companies in Kazakhstan.

H1.2: The extent of voluntary disclosure of information is positively affected by the number of non-executive (outside) directors of the banking companies in Kazakhstan.

The legitimacy theory assumes that since business organizations are socially constructed institutions, people in society have certain implicit and explicit expectations from corporations (DiMaggio and Powell 1991; Meyer and Rowan 1977). Through corporate disclosure practices, corporations should try to gain the trust, confidence, and support of society (Peters, Miller and Kusyk 2011). From a legitimacy theory perspective, corporations should act consistently with wider social priorities, and comply with social norms and practices (Liu and Taylor 2008). By voluntarily disclosing all financial and nonfinancial information, they should demonstrate compliance to societal stakeholders and use these practices as part of legitimate processes. However, as business organizations grow bigger and their activities become more visible, legitimacy issues gain greater importance. Therefore, larger corporations disclose more information than smaller ones (Omar and Simon 2011).

Usually larger organizations employ more employees than smaller organizations. Similarly, bigger organizations have more board of directors than smaller organizations. With large number of board of directors, companies need to have multiple and extensive information channels to communicate with them effectively. Therefore, size of the organizations has influence on their voluntary disclosure practices. Positive correlations between company size and disclosure practices are well documented in previous studies with substantial theoretical justifications (Parsa, Chong, and Isimoya 2007; Hassan, Giorgioni, and Romilly 2006). First, because of economies of scale, larger organizations see accumulation and dissemination of information is less costly than small organizations. Benefit of such dissemination could outweigh the cost, and further could bring some competitive advantage for them. Second, larger organizations are more involved with diverse stock and securities markets, and face more necessity to disclose information compared to smaller organizations. Third, top management of the smaller organizations are more apprehensive about disclosure practices as they are scared they will lose competitive position. Therefore, company size substantially influences their voluntary disclosure practices. Thus, we develop the following hypothesis for the banking companies in Kazakhstan.

H2: The amount of voluntary disclosures is positively correlated with the total assets of the banking companies in Kazakhstan.

According to the signaling theory (Nuruannnabi and Hossain 2012; Spence 1973), companies use their disclosure practices as part of their effort to reduce moral hazards through information dissemination as well as to send signals to their potential investors and stakeholders for future credentials. However, over time, companies become overloaded with information in different areas and find it impossible to communicate directly with their shareholders and circulate all relevant information (Hidalgo et al. 2010). Therefore, they use their annual disclosures as means to maintain contact and connect with external stakeholders. The maturity of firms, in terms of age, industry life cycle, and growth could influence disclosure practices (Neville 2011; Yuen, Yip, Ming, and Lu 2009). However, the results on the relationship between disclosure practices and age of the organizations are dichotomous. Some researchers found lower levels of disclosure for younger firms where as higher level of disclosures for long-time operating firms (Haniffa and Cooke 2002; Neville 2011; Yuen et al. 2009). Contrary to this, others found new and smaller organizations disclosing more information compared to competing older organizations (Nurunnabi and Hossain 2012). Therefore, we can assume those firms' years of operations and growth and developmental levels could influence their voluntary disclosure practices. On the basis of results of prior empirical research, we propose the following hypothesis.

> H3: There is a positive correlation between the age and the extent of voluntary disclosures of the banks in Kazakhstan.

Methodology

The aim of this study is to investigate the current state of voluntary disclosure practices followed by representatives of the banking sector listed on KASE for 2007–2010. In addition, the study reports the results of the relationship between company-specific characteristics and voluntary disclosures of the sample companies. Since 1993, the banking sector has undergone significant changes owing to banking reforms and the restructuring of external debts of three banks in 2009–2010 (BTA bank, Alliance bank, and TemirBank). Currently, the banking sector is one of the most developing segments of the country's financial system.

Population and Sample

Our sample consists of all the 39 commercial banks operating in Kazakhstan and listed on the KASE. The sample includes both public- and private-sector banks. KASE has been in operation since 1993. As the main center of financial market, KASE represents four major sectors: the shares and corporate bonds market, the government securities market, the foreign currency market, and the derivatives market. Currently, there are more than 110 public companies listed in KASE, although the KASE index list is mostly represented by only seven companies, mainly from the banking and oil and gas industries. Kazakhstan's capital market can be considered unique as compared to other industrialized markets (IMF 2009). The country's economic growth and exports significantly depend on its natural resources and banking sectors. Therefore, the composition of the listed companies in KASE reflects the country's economic representation. Unlike other mature capital markets, the corporate issuers representing various manufacturing sectors in KASE are relatively small, while unusually heavy representations can be observed in the banking and natural resources sectors.

Variable Measurement

We used 65 items measuring voluntary disclosures as refereed by other researchers (Hossain and Reaz 2007; Barako et al. 2006; Yuen et al. 2009). We denote the bank's disclosure score by *Y*, and the value of each particular item (*dj*) is set to 1 if it is present in a financial report and 0 otherwise. Similar to Hassan et al. (2006), we used the non-weighted approach to compute the total disclosure score for each bank.

$$Y = \sum_{j=1}^{65} d_j$$

Independent variables

Size = natural log of total assets.

Age = age of a bank in years; since only post-Soviet era experience is relevant, we compute the age of a bank only after 1985, ignoring its age before this year.

BSize = board size: number of directors.
OSize = number of outside directors on the board.
Ratio = ratio of outside directors on the board.

Applied Model
Ordinary Least Squares (OLS):

$$Y = \beta_0 + \beta_1 Size + \beta_2 Age + \beta_3 BSize + \beta_4 OSize + \beta_5 Ratio + \varepsilon$$

where Size, Age, BSize, OSize, and Ratio are measured as described above. We conducted correlation analysis among the independent variables (Table 7.3). Most of the variables are significantly correlated with each other. Therefore, we conducted factor analysis using Varimax rotation and principal components extraction to confirm that our variables represent independent factors (constructs). In addition, we used OLS regression with a stepwise forward method to test the relationship between total voluntary disclosure index and company-specific characteristics as stated in H1–H3 (Tables 7.5 and 7.6). This approach allows adding one variable at a time, starting from a variable with the highest explanatory power. We used a cut-off significance level of 10 percent because of the small sample size (39 banks).

Data Collection Method

We collected data on voluntary disclosure practices and governance aspects related to board characteristics from the annual reports and the investment memorandums of the commercial banks in Kazakhstan. As noted by Gaa (2010), an annual report plays an important role in an entity's efforts to construct its public image. In particular, data on voluntary disclosure were collected from banks' annual reports that are publicly available domain of the company websites. Data on board characteristics were obtained from annual reports and investment memorandums. We also used two other main sources for bank-specific information. Those are the Agency of Financial Control and Monitoring over Financial Market and Financial Institutions of Kazakhstan (http://www.afn.kz/), and the Depositary of Financial Statements (http://www.dfo.kz/).

Findings and Discussion

The descriptive statistics for the distribution of disclosure scores and independent variables are listed in Table 7.1. The highest and lowest overall disclosure scores are 53 and 14, respectively, and the mean value is 24.95, with a standard deviation of 7.77. The mean of the proportion of outside directors to total directors is 32.16 percent, indicating that a significant number of directors are outside directors. The board size ranged from 2 to 8, with an average board size of 4.67. The age (Age Years) statistics indicate that the average age of the sample banks is 16.46 years. The length of financial reports varies from 28 pages to 185 pages, with mean value of about 69 pages long. Table 7.2 lists the correlations among our hypothesized variables. As long as none of the variables pass tests for normal distribution and Pearson correlation coefficients (reported above the diagonal) can be misleading for non-normal distributions, we check their robustness by Spearman correlation coefficients (below the diagonal). High congruence of the correlation coefficients in terms of their value and its statistical significance can be assessed from Table 7.2. The inevitably high correlation outside directors with total directors and Out_to_Total Ratio can potentially lead to multicolinearity issue.

To test the relationship between total voluntary disclosure and company-specific characteristics as stated in H1–H3, we use the following steps. First, we split out sample into two subsamples by median value of pages in report (split values of 0 and 1 correspond to subsamples with the number of pages below and above the median, respectively; applicable for Tables 7.4–7.6). This is done in order to control for loss in voluntary disclosure score due to brevity of the report. Second, we run OLS regression in its simple form as well augmented by bootstrapping to mitigate loss of power that can result from small sample size. Bootstrapping is conducted by running the regression over 1,000 random subsamples stratified by pages in report variable. The results of the simple regression can be assessed from Tables 7.3 and 7.4, while the differences in statistical significance of coefficients obtained by simple OLS compared to the bootstrapped version from Tables 7.5 and 7.6.

As we can see from Table 7.4, significance of *F*-statistics supports validity of chosen independent variables in explaining voluntary disclosure

Table 7.1 Descriptive statistics of study variables

		Disclosure Score	Outside directors	Total directors	pages in report	Age years	LnAssets 2010	LnEqty 2010	RatioOut _to_Total
N	Valid	39	39	39	39	39	39	38	39
	Missing	0	0	0	0	0	0	1	0
Mean		24.95	1.56	4.67	68.59	16.46	17.86	16.57	.32
Median		24.00	1.00	5.00	62.00	17.00	17.82	16.27	.33
Mode		24	1	3	41[a]	17.00[a]	14.81[a]	14.59[a]	.33
Std. Deviation		7.77	.94	1.73	32.14	17.77	1.98	1.37	.13
Skewness		2.54	.40	.35	1.72	3.16	.32	.88	−.77
Minimum		14	0	2	28	.00	14.81	14.59	.00
Maximum		53	4	8	185	87.00	21.71	19.81	.67

[a]Multiple modes exist. The smallest value is shown.

Table 7.2 Correlations among variables (correlations matrix)

	Age (Years)	LnAssets 2010	Outside directors	Total directors	Ratio (Out to total)	pages in report
Age (Years)	1	.540**	.548**	.486**	.305	.478**
LnAssets 2010	.395*	1	.498**	.533**	.274	.791**
Outside directors	.377*	.426**	1	.795**	.754**	.572**
Total directors	.470**	.494**	.811**	1	.274	.535**
RatioOut_to_Total	.260	.285	.814**	.404*	1	.319*
pages in report	.536**	.785**	.532**	.567**	.354*	1

*Correlation is significant at the 0.05 level (2-tailed).
**Correlation is significant at the 0.01 level (2-tailed).

Table 7.3 Model summary of regression analysis

Split	R	R square	Adjusted R square	Std. error of the estimate
.00	.402[a]	.161	−.188	3.150
1.00	.791[a]	.626	.501	6.688

[a]Predictors: (Constant), RatioOut_to_Total, LnAssets2010, Total directors, AgeYears, Outside directors. Dependent Variable: Disclosure Score.

Table 7.4 Analysis of the variance of variables

Split		Sum of squares	df	Mean square	F	Sig.
.00	Regression	22.905	5	4.581	.462	.798[a]
	Residual	119.095	12	9.925		
	Total	142.000	17			
1.00	Regression	1122.817	5	224.563	5.020	.007[a]
	Residual	670.993	15	44.733		
	Total	1793.810	20			

[a]Predictors: (Constant), RatioOut_to_Total, LnAssets2010, Total directors, Age, Years, outside directors. Dependent Variable: Disclosure Score.

only if the report is long enough. The adjusted R^2 in this case is 0.501. This implies that 69.3 percent of the variation in total voluntary disclosure is explained by independent variables in the model. Compared to R^2 statistics from similar studies using disclosure indices, our R^2 is relatively higher than that reported by Haniffa and Cooke (2002) at 0.479, and

Table 7.5 Regression coefficients of variables

Split		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error	Beta		
.00	(Constant)	20.203	10.740		1.881	.084
	Age (Years)	−.024	.113	−.065	−.214	.834
	LnAssets2010	.380	.610	.178	.623	.545
	Outside directors	2.642	6.535	.646	.404	.693
	Total directors	−1.623	2.306	−.830	−.704	.495
	RatioOut_to_Total	−5.270	20.498	−.212	−.257	.801
1.00	(Constant)	−9.366	20.445		−.458	.653
	Age (Years)	−.023	.091	−.052	−.248	.807
	LnAssets2010	2.867	1.113	.531	2.576	.021
	Outside directors	15.403	6.763	1.619	2.278	.038
	Total directors	−5.180	2.615	−.875	−1.981	.066
	RatioOut_to_Total	−52.224	31.887	−.831	−1.638	.122

[a]Dependent Variable: Disclosure Score.

Table 7.6 Bootstrapped regression coefficients of variables

Split		B	Bootstrap[a]				
			Bias	Std. error	Sig. (2-tailed)	95% Confidence interval	
						Lower	Upper
.00	(Constant)	20.203	.810	4.869	.001	13.928	28.733
	Age(Years)	−.024	−.003	.046	.557	−.117	.043
	LnAssets2010	.380	.063	.107	.020	.335	.654
	Outside directors	2.642	1.330	3.438	.424	.037	10.232
	Total directors	−1.623	−.468	1.173	.046	−4.321	−.712
	RatioOut_to_Total	−5.270	−5.472	12.246	.518	−31.364	1.940
1.00	(Constant)	−9.366	5.543	11.938	.329	−19.331	19.088
	Age(Years)	−.023	−.019	.020	.451	−.076	−.010
	LnAssets2010	2.867	−.145	.268	.001	2.148	3.071
	Outside directors	15.403	3.093	5.768	.001	13.766	28.578
	Total directors	−5.180	−.988	2.454	.001	−10.399	−3.369
	RatioOut_to_Total	−52.224	−9.054	16.398	.001	−90.098	−47.557

[a]Unless otherwise noted, bootstrap results are based on 1000 stratified bootstrap sample.

Barako et al. (2006) at 0.534; however, it is lower than that documented by Hassan et al. (2006) at 0.863.

Company size (LnAssets 2010) has the highest explanatory power and significance level, while company age has the lowest. The coefficients of independent variables indicate both the magnitude and direction of the relationship with the dependent variable (Table 7.5). The number of outside directors on the board has a positive association and the most significant impact on disclosure score (adding one outside director increases the score by 15.403 points). Size measured by LnTotalAssets has a positive and significant association with disclosure score. These findings suggest that the size of a bank affects the voluntary disclosure level of banks in Kazakhstan. The total numbers of directors and board composition measured by Out_to_Total Ratio have a negative and significant (for one-sided hypothesis) association with the dependent variable. This is inconsistent with Hossain and Reaz (2007) but can be partially explained by peculiarities of our sample and model: when an outside director is added to the board, it results in average increase in Out_to_Total ratio from 0.33 (1.56/4.67 = mean value of outside directors divided by mean value of total directors) to 0.45 ((1.56 + 1)/(4.67 + 1)). The average increase of 0.12 (0.45 − 0.33) multiplied by −52.224 is equal to −6.26 of total negative impact on disclosure score. Therefore, net impact of an additional outside director is still positive even if diminished by −5.180 and −6.26 resulting from increase in total directors and Out_to_Total ratio, respectively. There is no association between age and voluntary disclosure. In other words, the age of a bank does not affect its disclosure level. A similar result was reported by Akhtaruddin (2005). We performed a robustness check via bootstrapping technique: conducted the regression over 1,000 random subsamples stratified by pages in report variable (Table 7.6). The results support our findings reported in Table 7.5. However, stratification on other variables has not resulted in such a significant increase in *t*-values of the reported coefficients.

Policy Implications and Conclusions

Development of better corporate reporting practices could have significant impact on Kazakhstan's long-term strategy due to its potential contribution to competitive advantage through better corporate disclosure, improved governance structures, transparency, innovations, and environment protection initiatives (Amran and Haniffa 2011; Mitton 2002). Implementing effective voluntary disclosure systems will enable companies to attract more foreign investors through better CG practices and transparency (Hossain and Reaz 2007; Shvyrkov 2011). This study investigated the extent and determinants of voluntary disclosure practices in the banking sector of Kazakhstan. The uniqueness of this study comes from the lack of similar studies in the banking sector of transition economies such as Kazakhstan. It will have a few contributions in the area of CG and voluntary disclosure practices. First, to the best of our knowledge, it is the pioneer study to explore voluntary disclosures and CG practices in Kazakhstan. Therefore, the findings will provide some implications to business communities and policy makers in Kazakhstan. As Kazakhstan is becoming the financial hub of Central Asian countries, global business communities will be the immediate beneficiaries of the study. Second, as Kazakhstan is striving to become one of the 50 most competitive nations by 2020, policy makers can compare the voluntary disclosure and CG practices of the KASE-listed companies to those of other developed countries. A comparison of existing disclosure practices with the desired ones can help policy makers develop appropriate and corrective policy measures for publicly listed companies in Kazakhstan (Kalyuzhnova and Nygaard 2008). The voluntary inclusion of widespread information can help the Kazakh banking companies improve their governance, accountability, management metrics, and analysis (GMAA) scores and subsequently gain higher credit ratings from international agencies (Shvyrkov 2011).

Third, as our study identified a positive correlation between the number of independent/outside directors and the extent of disclosure practices, Kazakh companies can learn some lessons from the study and appoint more outside directors to promote good governance and transparency in their routine activities (Haque et al. 2011). The Financial Services Authority (FSA) of Kazakhstan could play a significant role in selecting and training independent directors to improve the governance capacities of the banking companies. Recent initiatives of the "Big 4" audit companies to provide training and consulting to local banking companies could help to improve the disclosure and governance scenarios in

Kazakhstan. Fourth, as the CG code of Kazakhstan lacks in clarity on board responsibilities, the findings of this study can help reduce tensions and conflicts among board members. Future modifications of the code of CG could suggest the inclusion of more external members, thus ensuring more information disclosure and transparency in corporate reporting practices (Johannesson et al. 2012; Miller et al. 2005). An industry- or sector-specific accounting standard and financial reporting practices could be useful in this regard (Babenov 2010). Fifth, the study justified government initiatives to make it mandatory for all KASE-listed companies to adopt IFRS standards in reporting practices (Tyrrall et al. 2007). The nonlinear relationship between company age and disclosure practices further strengthen the arguments for those legal measures. Sixth, in recent years, publishing different financial information to the company website and informed customers and other stakeholders through social media proved to very effective to improve corporate transparency in different national contexts (Despina and Demetrios 2009; Nurunnabi and Hossain 2012). Banking companies could learn from recently launched "Peoples IPO programs," where government directly communicated with potential investors, i.e., all bank accountholders in Kazakhstan, through SMS services of the mobile operators about public offerings of large government corporations. Updating shareholders through their e-mails and mobile phones could be effective means to communicate about major investments or other strategically important decisions. Therefore, banking companies in Kazakhstan could use Internet and other social media to disclose diversified information to different stakeholder groups and improve their CG image substantially.

However, this study is subject to a few limitations. First, we expect moderate external validity of our results. Regulatory frameworks and economic conditions of Kazakhstan are unique and different from other developed and emerging markets. Therefore, this study reflects only specific characteristics of the banking sector of Kazakhstan. Second, the study explores only one specific sector of the financial system, the banking sector. Although the banking sector is one of the main sectors of the economy, there are other important industries such as oil and gas, mining, and construction industries, which should be addressed by future research studies. Third, the sample size of the study is relatively small and covers data only for one year. Therefore, a comprehensive data of 5–10 years of the banking industry could reflect better picture of voluntary disclosure practices in Kazakhstan. Finally, the study does not include all of the important variables used in prior studies. For example, Steurer (2006) argued that structural complexity, defined as the number of subsidiaries of a particular bank, has a significant influence on voluntary disclosure practices. Some studies also suggest that cross-listing also affects the extent of voluntary disclosure. For example, Mitton (2002) reports a positive association between cross-listing and the corporate disclosure index. Therefore, future research with more variables could be initiated to understand the CG and voluntary disclosure practices in Kazakhstan.

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CHAPTER 8

Corporate Governance Disclosures and Firm performance

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Abstract

The study examined the effect of corporate governance on the performance of firms in developing economies by using both market- and accounting-based performance measures. The study made use a sample of listed companies from South Africa and Ghana for short descriptive cases, scenarios, and vignettes. It adopted an in-depth, exploratory approach in reviewing the corporate governance issues from the perspectives of principles, regulations, and performance of the top firms.

Results indicate that the direction and the extent of impact of governance are dependent on the performance measure being examined. Specifically, the findings show that large and independent boards enhance firm value and that combining the positions of chief executive officer (CEO) and board chair has a negative impact on corporate performance. The CEO's tenure in office enhances a firm's profitability, while board activity intensity affects profitability negatively. The size of audit committees and the frequency of their meetings have positive influence on market-based performance measures and that institutional shareholding enhances market valuation of firms. Finally, results point out that country characteristics influence the impact of governance on corporate performance.

Keywords: corporate governance, ownership structure, developing countries, performance, return on asset, managerial shareholding, board of directors, institution ownership.

Introduction

Corporate governance has become a popular discussion topic in developed and developing countries. Effective corporate governance has been identified to be critical to all economic transactions especially in emerging and transition economies (Dharwardkar et al. 2000). The widely held view that corporate governance determines firm performance and protects the interests of shareholders has led to increasing global attention. However, the way in which corporate governance is organized differs between countries, depending on the economic, political, and social contexts. For example, firms in developed countries have dispersed shareholders and operate within stable political and financial systems, well-developed regulatory frameworks, and effective corporate governance practices. However, firms that operate in developing countries, such as Kenya, may be affected by political instability, resulting in severe economic dislocation and sharp escalation in defense expenditure, which result in a widening fiscal deficit.

Corporate governance could be defined as "ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors" (Mayer 1997). The structures and practices of boards differ across national boundaries, as boards have evolved according to each country's history, culture, laws, and economy. On the African continent, corporate governance matters are driven by countries' companies codes, securities and exchange commissions, the stock exchange listing requirements, regulations and rules, and other country-specific regulatory agencies. Although corporate governance in Africa is off on a good start, insufficient empirical research limit the basis for comparison of the continent's corporate governance experiences and outcomes with other continents.

In this chapter, a set of significant case studies based on corporate governance and performance in both South Africa and Ghana is presented. This set of case studies is used to illustrate nature of corporate governance practices and performance that occurs in developing country subject to considerable international scrutiny of its business practices.

The remainder of the chapter proceeds as follows. In the next section, a review of the theories on and benefits of corporate governance are presented. This is followed by the role of internal corporate governance mechanism in an organizational performance. This section ends with capital market and corporate governance. Finally, case studies on both South Africa and Ghana are presented. The chapter ends with a concluding remark that summarizes how corporate governance relates to performance in developing economies. This main objective of this chapter is to explore the relationship between corporate governance disclosures and performance.

Defining Corporate Governance

Corporate governance is a uniquely complex and multifaceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis, and solutions lie in multidisciplinary fields, i.e., economics, accountancy, and finance among others (Cadbury 2002). As such it is essential that a comprehensive framework be codified in the accounting framework of any organization. In any organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. The health of the organization depends on the underlying soundness of its individual components and the connections between them.

According to Morck, Shleifer, and Vishny (1989), among the main factors that support the stability of any country's financial system include the following: good corporate governance; effective marketing discipline; strong prudential regulation and supervision; accurate and reliable accounting financial reporting systems; and a sound disclosure regimes and an appropriate savings deposit protection system.

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However, they all have pointed to the same end, hence giving more of a consensus in the definition. Coleman and Nicholas-Biekpe (2006) defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. However, Mayer (1999) offers a definition with a wider outlook and contends that it means the sum of the processes, structures, and information used for directing and overseeing the management of an organization. The Organization for Economic Corporation and Development (OECD) (1999) has also defined corporate governance as a system on the basis of which companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management, and shareholders) and formulate rules and procedures for adopting decisions on corporate matters.

In another perspective, Arun and Turner (2002) contend that there exists a narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interests. However, Shleifer and Vishny (1997); Vives (2000); and Oman (2001) observed that there is a broader approach that views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they can earn a return on their investment. There is a consensus, however, that the broader view of corporate governance should be adopted in the case of banking institutions because of the peculiar contractual form of banking, which demands that corporate governance mechanisms for banks should encapsulate depositors as well as shareholders (Macey and O'Hara 2001). Arun and Turner (2002) supported the consensus by arguing that the special nature of banking requires not only a broader view of corporate governance but also government intervention in order to restrain the behavior of bank management. They further argued that the unique nature of the banking firm, whether in the developed or developing world, requires that a broad view of corporate governance, which encapsulates both shareholders and depositors, be adopted for banks. They posit that, in particular, the nature of the banking firm is such that regulation is necessary to protect depositors as well as the overall financial system (Arun and Turner 2002).

Theories of Corporate Governance

Corporate governance is of growing importance, particularly with regard to the monitoring role of the board of directors. As a result, these theoretical perspectives based on the governance structures and reporting practices affect the value of the firms. This section reviews the theoretical perspectives of a board's accountability. It draws on agency theory, stewardship theory, stakeholder theory, social contract theory, legitimacy theory, and resource dependency theory.

Agency Theory

Much of the research into corporate governance derives from agency theory. Since the early work of Berle and Means (1932), corporate governance has focused upon the separation of ownership and control, which results in principal–agent problems arising from the dispersed ownership in the modern corporation. They viewed corporate governance as a mechanism where a board of directors is an essential monitoring device to minimize the problems brought about by the principal–agent relationship. In this context, agents are the managers, principals are the owners, and the board of directors act as the monitoring mechanism (Mallin 2004). Furthermore, literature on corporate governance attributes two factors to agency theory. The first factor is that corporations are reduced to two participants, managers and shareholders whose interests are assumed to be both clear and consistent. A second notion is that humans are self-interested and unwilling to sacrifice their personal interests for the interests of the others (Daily, Dalton, and Cannella 2003).

Firms can be described as a nexus of contracts among individual factors of production resulting in the emergence of the agency theory. The firm is not an individual but a legal fiction, where conflicting objectives of individuals are brought into equilibrium within a framework of contractual relationships. These contractual relationships are not only with employees, but with suppliers, customers, and creditors (Jensen and Meckling 1976). The intention of these contracts is that all the parties acting in their self-interest are motivated to maximize the value of the firm, reducing the agency costs and adopting accounting methods that most efficiently reflect their own performance.

The focus of agency theory on the principal and agent relationship (e.g., shareholders and corporate managers) has created uncertainty due to various information asymmetries. The separation of ownership from management can lead to managers of firms taking action that may not maximize shareholders wealth, due to their firm-specific knowledge and expertise, which would benefit them and not the owners; hence, a monitoring mechanism is designed to protect the shareholder interest (Jensen and Meckling 1976). This emphasizes the role of accounting in reducing the agency cost in an organization, effectively through written contracts tied to the accounting systems as a crucial component of corporate governance structures, because if a manager is rewarded for their performance such as accounting profits, they will attempt to increase profits, which will lead to an increase in bonus or remuneration through the selection of a particular accounting method that will increase profit.

Arising from the aforementioned point is the agency problem on how to induce the agent to act in the best interests of the principal. This results in agency costs, for example, monitoring costs and disciplining the agent to prevent abuse (Shleifer and Vishny 1997). Jensen and Meckling (1976) define agency cost as follows: the sum of monitoring expenditure by the principal to limit the aberrant activities of the agent; bonding expenditure by the agent that will guarantee that certain actions of the agent will not harm the principal or to ensure the principal is compensated if such actions occur; and the residual loss that is the dollar equivalent to the reduction of welfare as a result of the divergence between the agent's decisions and those decisions that would maximize the welfare of the principal. However, the agency problem depends on the ownership characteristics of each country. In countries where ownership structures are dispersed, if the investors disagree with the management or are disappointed with the performance of the company, they use the exit options, which will be signaled through reduction in share prices. However, countries with concentrated ownership structures and large dominant shareholders tend to control the managers and expropriate minority shareholders in order to gain private control benefits (Spanos 2005).

The agency model assumes that individuals have access to complete information and investors possess significant knowledge of whether governance activities confirm to their preferences and the board has knowledge of investors' preferences (Smallman 2004). Therefore according to the view of the agency theorists, an efficient market is considered a solution to mitigate the agency problem, which includes an efficient market for corporate control, management labor, and corporate information (Clarke 2004).

According to Johanson and Ostergen (2010) even though agency theory provides a valuable insights into corporate governance, its applicability is to countries in the Anglo-Saxon model of governance.

Stewardship Theory

In contrast to agency theory, stewardship theory presents a different model of management, where managers are considered good stewards who will act in the best interest of the owners. The fundamentals of stewardship theory are based on social psychology, which focuses on the behavior of executives. The steward's behavior is pro-organizational and collectivistic, and has higher utility than individualistic self-serving behavior and the steward's behavior will not depart from the interest of the organization because the steward seeks to attain the objectives of the organization. According to Smallman (2004) where shareholders wealth is maximized, the steward's utilities are maximized too, because organizational success will serve most requirements and the stewards will have a clear mission. He also states that stewards balance tensions between different beneficiaries and other interest groups. Therefore, stewardship theory is an argument put forward for firm performance that satisfies the requirements of the interested parties resulting in dynamic performance equilibrium for balanced governance.

Stewardship theory sees a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximize shareholder wealth through firm performance. A steward, who improves performance successfully, satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organizational wealth (Davis, Schoorman, and Donaldson 1997). When the position of the CEO and chairman is held by a single person, the fate of the organization and the power to determine strategy is the responsibility of a single person. Thus, the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control (Davis, Schoorman, and Donaldson 1997). Therefore, stewardship theory takes a more relaxed view of the separation of the role of chairman and CEO, and supports appointment of single person for the position of chairman and CEO and a majority of specialist executive directors rather than nonexecutive directors (Clarke 2004).

Stakeholder Theory

Research into corporate governance also discusses the stakeholder theory in relation to firms' responsibility to the wider community. A stakeholder is any group of individuals who can affect or is affected by the activities of the firm, in achieving the objectives of the firm (Freeman 1984). A similar view has been put forward by the World Business Council for Sustainable Development (1997), which also identifies stakeholders as the representatives from labor organizations, academia, church, indigenous peoples, human rights groups, government and nongovernmental organizations and shareholders, employees, customers/consumers, suppliers, communities, and legislators. A firm's objective could be achieved through balancing the conflicting interests of these various stakeholders. Therefore, a fundamental aspect of stakeholder theory is to identify the stakeholders an organization is responsible for. Any stakeholder is relevant if their investment is, in some form, subject to risk from the activities of the organization.

Corporate governance systems are in a state of transition due to internationalization of capital markets, resulting in convergence of the shareholder value-based approach to corporate governance and the stakeholder concept of corporate governance toward sustainable business systems (Clarke 1998). It can be seen that stakeholder theory is an extension of the agency perspective, where responsibility of the board of directors is increased from shareholders to other stakeholders' interests (Smallman 2004). Therefore, a narrow focus on shareholders has undergone a change and is expected to take into account a broader group of stakeholders such as those interest groups linked to social, environmental, and ethical considerations (Freeman, Wicks, and Parmar 2004). As a result, stakeholder theory supports the implementation of Corporate Social Responsibility and endorses risk-management policies to manage diverse interests.

Criticisms that focus on stakeholder theory identify the problem of who constitutes genuine stakeholders. One argument is that meeting stakeholders' interests also opens up a path for corruption, as it offers agents the opportunity to divert the wealth away from the shareholders to others (Smallman 2004). But the moral perspective of stakeholder theory is that all stakeholders have a right to be treated fairly by an organization, and managers should manage the organization for the benefit of all stakeholders, regardless of whether the stakeholder management leads to better financial performance.

Legitimacy Theory

Another theory reviewed in corporate governance literature is legitimacy theory. Legitimacy theory is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate with some socially constructed systems of norms, values, beliefs and definitions" (Suchman 1995). Similar to social contract theory, legitimacy theory is based upon the notion that there is a social contract between the society and an organization. A firm receives permission to operate from the society and is ultimately accountable to the society for how it operates and what it does, because society provides corporations the authority to own and use natural resources and to hire employees.

Traditionally, profit maximization was viewed as a measure of corporate performance. But according to the legitimacy theory, profit is viewed as an all-inclusive measure of organizational legitimacy.

The emphasis of legitimacy theory is that an organization must consider the rights of the public at large, not merely the rights of the investors. Failure to comply with societal expectations may result in sanctions being imposed in the form of restrictions on firms operations, resources, and demand for its products. Much empirical research has used legitimacy theory to study social and environmental reporting, and proposes a relationship between corporate disclosures and community expectations. The increasing scrutiny on corporate governance directly and indirectly affects information technology and the direction information technology will take. Furthermore, an era where technology is critical to business, corporate is incomplete without adequate information technology governance. Information technology governance is the responsibility of the board of directors and executive management. New digital and social networking technologies are making boards more morally and ethically observant and activist shareholders are able to publicize failures of organizations and thereby threaten reputational harm globally.

Potential Benefits of Corporate Governance

The effectiveness of corporate governance depends on the application of principles in a manner that benefits stakeholders, as well as broader industries and economic sectors. Benefits to stakeholders include resolving conflicts of interest, instilling controls and a sense of ethics, and enforcing and encouraging transparency.

Corporate governance promotes efficient use of resources within the firm and the larger economy. It also helps firm's to attract low-cost investment capital through improved investor and creditor confidence, both nationally and internationally. It also increases the firms' responsiveness to the need of the society and results in improving long-term performance (Gregory and Simms 1999).

Good governance promotes firmwide efficiency and a fair return for investors. Furthermore, good governance can benefit a company through better flow of funds and improved access to low-cost capital, strong internal controls, and discipline, and might achieve better credit ratings that would lead to lower debt funding and higher stock price valuation, which can result in equity dilution when additional stock is floated. Companies that are properly governed are supported by deep and transparent financial markets, robust legal systems, and efficient resource allocation. This, in turn, promotes financial and economic stability and increases national and global growth rates, whereas poorly governed companies do the opposite. Good corporate governance brings better management and prudent allocation of the company's resources, and enhances corporate performance that would significantly contribute to the appreciation company's share price.

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision making. In expectation of such an improvement, the firm's value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty (Imam 2006).

Good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, which is another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationships with such firms, as the relationships are likely to be more prosperous, fairer, and long lasting than those with firms with less effective governance.

Implications for the economy as a whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at the firm level, the capital market will also be boosted and become more developed, which is essential for sustained economic growth. At the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big businesses and political power may result in a more favorable business environment for smaller enterprises and more equitable income distribution (Iskander and Chamlou 2000).

Comply or Explain

In the wake of corporate scandals like Polly Peck (UK), Enron (U.S.), and Metallgesellschaft (Germany), there have been increasing calls for more effective regulation of corporate behavior in general and the actions of company directors in particular. In response to that, various laws on issues of corporate governance have been passed in many countries around the world. In addition, in recent years there has been a strong trend toward the adoption of "soft law" (Mörth 2004) or "soft regulation" (Sahlin-Andersson 2004) in the form of *codes of corporate governance*. A code of corporate governance can be defined generally as "a non-binding set of principles, standards or best practices, issued by a collective body and relating to the internal governance of corporations" (Weil and Manges 2002).

A central element of most national codes is the "comply-or-explain" principle, which was first put forward in the Cadbury Code as a practical means of establishing a single code of corporate governance while avoiding an inflexible "one size fits all" approach. Cadbury (1992) required that, "Listed companies… should state in the report and accounts whether they comply with the Code and identify and give reasons for any areas of non-compliance."

Comply or explain is a regulatory approach used in the United Kingdom, Germany, the Netherlands, and other countries in the field of corporate governance and financial supervision. Rather than setting out binding laws, government regulators (in the United Kingdom, the Financial Reporting Council, in Germany, under the Aktiengesetz) set out a code, which listed companies may either comply with, or if they do not comply, explain publicly why they do not. The UK Corporate Governance Code, the German Corporate Governance Code (or Deutscher Corporate Governance Kodex), and the Dutch Corporate Governance Code "Code Tabaksblat" use this approach in setting minimum standards for companies in their audit committees, remuneration committees, and recommendations for how good companies should divide authority on their boards.

The purpose of comply or explain is to let the market decide whether a set of standards is appropriate for individual companies. Since a company may deviate from the standard, this approach rejects the view that one size fits all, but, because of the requirement of disclosure of explanations to market investors, anticipates that if investors do not accept a company's explanations, then investors will sell their shares, hence creating a market sanction, rather than a legal one. The concept was first introduced after the recommendations of the Cadbury Report of 1992.

"Comply or explain" is appropriate in the sense that a company should explain if it does not comply. Discretion on compliance should not be as broad as it is without making some provisions mandatory. The suggestion is that it should apply the principles or explain (already adopted by King the III in South Africa) rather than comply with the provision or explain. This is not a good move in the right direction as there is more room for to say they apply a principle when they probably don't. Consideration should be given to making some current "comply or explain" corporate governance provisions mandatory, and to requiring shareholder approval for departure from any aspect of the corporate governance code. Some might say that an approach with more mandatory rules has been shown, as with the U.S. experience, not to be any more effective. But how much worse might the U.S. experience have been without their Securities and Exchange Act, without their Sarbanes-Oxley Act (with penalties of up to $5,000,000 fine and prison for 20 years),and so on?

Sir Adrian Cadbury supported a principles-based approach to corporate governance, rather than a rules-based approach. He has argued that rules can be "got round" more easily than principles. For instance, if a rule stated that the chairman should not also be the chief executive, then a company could observe the rule by designating one person as the CEO and another as the chairman, even though the reality might be different. On the other hand, if there were a principle that excessive concentration of power at the top of the company should be avoided, then such a principle might be harder to avoid. However, this approach does require the principles to be mandatory. For the United Kingdom and other parts of the world, disclosure has been inadequate and applying the principles is not mandatory. Indeed, by their nature, principles would be harder than rules to make mandatory. Vince Cable who is to bring in tougher penalties for "dodgy directors" in the United Kingdom said companies will be forced to list their true owners on a public register in a bid to combat tax evasion and money laundering. He stated "it is only right to put the toughest possible sanctions in place, make sure they stamp out unfair practices and deter those who are looking to act dishonestly." Dishonest directors can cause a huge amount of harm in terms of large financial losses, unnecessary redundancies, and lifelong investments going down the drain. Tackling the damaging behavior of a small minority of individuals will help to reinforce confidence in the majority of directors who run their businesses well and create jobs and growth in the economic environment.

The new rules, which need parliamentary approval, would force UK-registered firms to give details of anyone with an interest in more than 25 percent of its shares or voting rights. These details, held by Companies House, would need to be updated every year. Under the new measures, there would be greater freedom for courts to ban those with fraud convictions overseas from setting up in Britain, which could have prevented the Italian businessman Massimo Cellino from becoming a director of Leeds United Football Club. Courts would also have the power to force directors to compensate those who have lost out because of misconduct or serious failures in a business.

Judges in such cases would also have a duty to take past misdemeanors into account when deciding whether to disqualify a director, including previous business failures, the nature of any losses, overseas conduct, and breaches of specific laws. This will indeed help fight corruption in companies

The Role of Internal Corporate Governance Mechanisms in Organizational Performance

According to Dallas (2004), various instruments are used in financial markets to improve corporate governance and the value of a firm. Economic and financial theory suggests that the instruments mentioned in the following affect the value of a firm in developing and developed financial markets. These instruments and their role are as follows.

Role of Auditor

The role of an auditor is important in implementing corporate governance principles and improving the value of a firm. The principles of corporate governance suggest that auditors should work independently and perform their duties with professional care. In case of any financial manipulation, the auditors are held accountable for their actions as the availability of transparent financial information reduces the information asymmetry and improves the value of a firm (Bhagat and Jefferis 2002).

However, in developing markets, auditors do not improve the value of a firm. They manipulate the financial reports of the firms and serve the interests of the majority shareholders, further disadvantaging the minority shareholders. The weak corporate law and different accounting standards also deteriorate the performance of the auditors and create financial instability in the developing market.

Role of Board of Directors' Composition

The board of directors can play an important role in improving corporate governance and the value of a firm (Hanrahan, Ramsay, and Stapledon 2001). The value of a firm is also improved when the board performs its fiduciary duties such as monitoring the activities of management and selecting the staff for a firm. The board can also appoint and monitor the performance of an independent auditor to improve the value of a firm. The board of directors can resolve internal conflicts and decrease the agency cost in a firm. The members of a board should also be accountable to the shareholders for their decisions as argued by Nikomborirak (2001) and Tomasic, Pentony, and Bottomley (2003), *Fiduciary Duties of Directors:* Interview Schedule, Personal Communication. Melbourne.

The board consists of two types of directors: outsider (independent) and insider directors. The majority of directors in a board should be independent to make rational decisions and create value for the shareholders. The role of independent directors is important to improve the value of a firm as they can monitor the firm and can force the managers to take unbiased decisions. The independent directors can also play a role of a referee and implement the principles of corporate governance that protect the rights of shareholders (Bhagat and Jefferis 2002; Tomasic, Pentony, and Bottomley 2003).

Similarly, internal directors are also important in safeguarding the interests of shareholders. They provide the shareholders with important financial information, which will decrease the information asymmetry between managers and shareholders as argued by Bhagat and Black (2002) and Bhagat and Jefferis (2002). The board size should be chosen with the optimal combination of inside and outside directors for the value creation of the investors. The boards of directors in the developing market are unlikely to improve the value of a firm, as the weak judiciary and regulatory authority in this market enables the directors to be involved in biased decision making that serves the interests of the majority shareholders and the politicians providing a disadvantage to the firm.

Role of Chief Executive Officer

The CEO of an organization can play an important role in creating the value for shareholders. The CEO can follow and incorporate governance provisions in a firm to improve its value (Brian 1997; Defond and Hung 2004). In addition, the shareholders invest heavily in the firms having higher corporate governance provisions as these firms create value for them (Morin and Jarrell 2001).

The decisions of the board about hiring and firing a CEO and their proper remuneration have an important bearing on the value of a firm as argued by Holmstrom and Milgrom (1994). The board usually terminates the services of an underperforming CEO who fails to create value for shareholders. The turnover of CEO is negatively associated with firm performance especially in developed markets because the shareholders lose confidence in these firms and stop making more investments. It is the responsibility of the board to determine the salary of the CEO and give him proper remuneration for his efforts (Monks and Minow 2001). The board can also align the interests of the CEO and the firm by linking the salary of a CEO with the performance of a firm.

This action will motivate the CEO to perform well because his own financial interest is attached to the performance of the firm.

The tenure of a CEO is also an important determinant of the firm's performance. CEOs are hired on short-term contracts and are more concerned about the performance of the firm during their own tenure causing them to lay emphasis on short- and medium-term goals. This tendency of the CEO limits the usefulness of stock price as a proxy for corporate performance (Bhagat and Jefferis 2002). The management of a firm can overcome this problem by linking some incentives for the CEO with the long-term performance of the firm (Heinrich 2002).

The Role of Board Size

Board size plays an important role in affecting the value of a firm. The role of a board of directors is to discipline the CEO and the management of a firm so that the value of a firm can be improved. A larger board has a range of expertise to make better decisions for a firm as the CEO cannot dominate a bigger board because the collective strength of its members is higher and can resist the irrational decisions of a CEO.

On the other hand, large boards affect the value of a firm in a negative manner as there is an agency cost among the members of a bigger board. Similarly, small boards are more efficient in decision making because there is less agency cost among the board members.

Role of CEO Duality

Similar to the other corporate governance instruments, CEO duality plays an important role in affecting the value of a firm. A single person holding both the chairman and CEO role improves the value of a firm as the agency cost between the two is eliminated. On the negative side, CEO duality lead to worse performance as the board cannot remove an underperforming CEO and can create an agency cost if the CEO pursues his own interest at the cost of the shareholders.

Role of Managers

Managers can play an important role in improving the value of a firm. They can reduce the agency cost in a firm by decreasing the information asymmetry, which results in improving the value of a firm (Monks and Minow 2001). Managers in the developed market create agency cost by under and overinvestment of the free cash flow. Shareholders are disadvantaged in this case as they pay more residual, bonding, and monitoring costs in these firms.

Managers in developing financial markets generally play a negative role in the value creation of investors. The rights of the minority shareholders are suppressed and the firms in these markets cannot produce real value for shareholders as actions of the managers mostly favor the majority shareholders. The management and the shareholders in a developing market do not use the tools of hostile takeover and incentives to control the actions of managers. In the case of a hostile takeover, the managers are forced to perform well to be able to hold their jobs. Similarly, appreciation and bonuses can motivate managers to produce value for shareholders (Bhagat and Jefferis 2002).

The ownership of the management in a firm has an important bearing on its value. Firms can improve their value in developing markets by streamlining the interests of managers with those of the shareholders. This results in the convergence of the goals of shareholders and managers, ultimately improving the value of the shareholders.

Capital Markets and Corporate Governance

A capital market is the place to issue and trade debt and equity capital, which is important to global financial systems and for the survival and growth of the national economies. Firms may not be able to operate or exist if they are unable to access primary capital, in which case corporate governance would not be relevant as there would be no suppliers of capital. The economic growth of a business depends on its role in creating safe, efficient, and competitive capital markets. The life blood of capital markets is the capital provided by investors. This capital must therefore be protected through appropriate regulations, effective corporate governance, and the optimal market mechanism. Globalization has resulted in the flow of capital from international markets enabling firms to access capital from a much larger pool of investors. To reap the benefits of the global capital markets and attract long-term capital, corporate governance practices must be credible and well understood across borders. Even if countries do not rely on foreign investments, adherence to corporate governance practices will increase the confidence of the domestic investors, reduce the cost of capital, and induce a more stable source of capital (OECD 1999).

The ability of capital markets to attract capital depends on various factors including investors having confidence in the integrity and transparency of the markets. Confidence is earned over time through honest and fair markets, and provides investors with the material information necessary to make informed decisions.

Some of the key drivers of economic growth of a country are investor confidence and its capital markets. The efficiency of the stock market has an important implication for investors and regulatory authorities. Therefore, efficiency in information dissemination ensures that funds are allocated to investment projects that result in higher returns with necessary adjustments to risks.

Sustainability of public companies is considered the key to investor confidence, which requires accurate financial reports for investors to make informed investment decisions. Financial information, which is reliable, accurate, and transparent, is important to the efficiency, integrity, and safety of capital markets. As a result, investors rely on the quality of corporate financial reports in making rational investment decisions. Therefore, financial statements are a vital form of information to capital markets and their participants.

Disclosure of information over and above the accounting regulations has benefits in the capital markets. Those items of information that are contained within the annual reports and those that are made through media and press releases and conference calls to security analysts are information that is voluntarily disclosed. Firms with more informative disclosure policies tend to have a larger analyst following. Accurate analyst earnings forecasts always tend to result in reduced information asymmetry. Increased voluntary disclosures are associated with low cost of capital.

Corporate Governance Practices in Emerging Economies

One of the reasons for emerging economies to consider external corporate governance is the need to build investor confidence to attract foreign and local investment to expand their businesses. International donor agencies such as the IMF and World Bank as well as organizations such as the Organization for Economic Cooperation and Development (OECD) indirectly influence developing countries to improve their external corporate governance mechanisms and regulatory infrastructure. The effects of these changes can be seen in the actions of investors who are increasingly becoming confident in investing in some markets that were considered risky at one stage. However, the corporate sectors in emerging countries do seem to lag behind the benchmark for sound corporate governance.

The economic crisis that hit the South East Asian stock markets in 1997–1998 was partly attributed to weak corporate governance in the region, which prompted governments to consider ways of improving governance structures in their countries (Mobius 2002). This resulted in governance reforms in the emerging markets for restoring investor confidence by providing a secure institutional platform to build an investment market (Monks and Minow 2004 305). Therefore, codes of corporate governance were established by most of these countries to promote a continuous flow of funds and to boost investor confidence in their capital markets (Haniffa and Hudaib 2006). Even though emerging markets are aware of the concept of corporate governance, implementation of corporate governance practices has not been effective (Mobius 2002). The codes, which were derived from recommendations in developed countries, may not be applicable to developing countries due to their national character, and economic and social priorities. Therefore, what is effective in one country may not be so in another. Likewise, every corporation has its unique characteristics due to their history, culture, and business goals. Hence, all these factors need to be taken into account in their efforts to reform corporate governance (Haniffa and Hudaib 2006).

As the business environment of the developed countries is different from that of emerging countries, the governance structures designed to enhance performance should take into account the unique business environment that exists in the country without blindly adopting the practices from other countries. For example, Haniffa and Hudaib (2006) concluded, from a study on Malaysian listed companies, that the applicability of recommendations derived by the Cadbury Report and Hampel Report in the United Kingdom may be disputable due to high ownership concentration, close control by owners and substantial shareholders, cross-holdings of share ownership or pyramiding, and the close relationship between the firms, banks, and government. Corporate governance is affected by the ownership structure of the firm in the emerging markets.

Cases

South Africa

By the late 1980s, many of South Africa's corporations were bloated, unfocused, and run by entrenched and complacent managers. These firms were sustained and tolerated by a very different environment from that in advanced economies and capital markets. The mainstay of the South African environment was isolation. Tariffs and political isolation shielded firms from foreign product competition, while financial sanctions kept international institutions out of the domestic capital market, and South African firms out of international capital markets.

Corporate practices fell behind international norms, as did laws and regulations. In 2001, little of that comfortable, introverted world remained. With political reform, engagement and change have replaced isolation and stasis. South African corporations, their managers, and domestic shareholders have been exposed, in succession, to a new political system, rapid trade liberalization, demanding international investors, an emerging markets crisis, and rapid-fire regulatory reform.

Within 36 months, corporate governance has in South Africa changed from being a "soft" mainly ethical issue to a "hard" issue, recognized as pivotal to the success and revitalization of the country's capital markets and, ultimately, the prospects of the corporate economy (Malherbe and Segal 2001). These high stakes have produced a succession of measures aimed at transforming corporate governance in the economy.

Corporate structure has changed irrevocably. In 1994, the King Report on Corporate Governance (King I) was published by the King Committee on Corporate Governance, headed by former high court judge, Mervyn King S.C. King I, incorporating a code of corporate practices and conduct, was the first of its kind in the country, and was aimed at promoting the highest standards of corporate governance in South Africa.

Over and above the financial and regulatory aspects of corporate governance, King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although ground breaking at the time, the evolving global economic environment together with recent legislative developments have necessitated that King I be updated. To this end, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa 2002 (King II).

King II acknowledges that there is a move away from the single bottom line (i.e., profit for shareholders) to a triple bottom line, which embraces the economic, environmental, and social aspects of a company's activities. In the words of the King Committee:

> . . . successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company.

The King III report on corporate governance, strategy, and sustainability recommends that firms produce an integrated report in place of an annual financial report and a separate sustainability report. The report stated that companies create sustainability reports according to the Global Reporting Initiatives and Sustainability Reporting Guidelines (Dekker, 2002).

In contrast to the earlier versions, King III's report is applicable to all entities, public, private, and nonprofit. The report encourages all entities to adopt the King III principles and explain how these have been applied or are not applicable. It incorporated a number of global emerging governance trends such as alternative dispute resolution, risk-based internal audit, shareholder approval of nonexecutive directors' remuneration and evaluation of board, and directors' performance.

A number of new principles have been incorporated to address elements not previously included in the King II reports. Examples of such principles are IT governance, business rescue, and fundamental and affected transactions in terms of director's responsibilities during mergers, acquisitions, and amalgamations.

Again, the code of corporate governance is not enforced through legislation. However, owing to evolutions in South African law, many of the principles put forward in King II are now embodied as law in the Companies Act of South Africa of 2008. In addition to the Companies Act, there are additional applicable statutes that encapsulate some of the principles of King III such as the Public Finance Management Act and the Promotion of Access to Information Act.

Ntim and Osei (2011) found a statistically significant and positive association between the frequency of corporate board meetings and corporate performance, implying that South Africa boards that meet more frequently tend to generate higher financial performance. Their further investigation indicates a significant nonmonotonic link between the frequency of corporate board meetings and corporate performance, suggesting that either a relatively small or large number of corporate board meetings impacts positively on corporate performance.

Ghana

In Ghana corporate governance has been gaining roots in response to initiatives by some stakeholders such as the Ghana Institute of Directors

(IoD-Ghana), in collaboration with the Commonwealth Association of Corporate Governance, to address corporate governance in Ghana (Kyereboah-Coleman 2005). Again, there have been other initiatives designed to address corporate governance issues in the country. For instance, a study, conducted and launched by IoD-Ghana in 2001, pointed out that there is an increasing acceptance of good corporate governance practices by businesses in the country.

Notwithstanding the aforementioned developments, it must be indicated that more formal corporate governance structures and institutions are relatively not widespread. Good corporate governance has been highlighted to be vital to corporate organizations especially in transition and emergent economies. The effectiveness of a company's corporate governance structure has a far-reaching effect on how well it functions.

The regulatory framework for an effective corporate governance practice in Ghana is contained in the Companies code 1963 (Act 179), Securities Industry Law 1993 (PNDCL 333) as revised by the Securities Industry (Amendment) Act, 2000 (Act 590), and the listing regulations, 1990 (L.I. 1509) of the Ghana stock exchange. The regulatory framework of Ghana for effective corporate governance has been divided into six major sections, which are as follows:

1. the mission, responsibilities, and accountability of the board;
2. committees of the board;
3. relationship to shareholders and stakeholders, and the rights of shareholders;
4. financial affairs and auditing;
5. disclosures in annual reports; and
6. code of ethics. It may be useful now to proceed to discuss in detail the various sections of the regulatory framework of Ghana.

Studies by Mensah et al. (2003) on corporate governance and corruption revealed that poor corporate governance practices among a sample of surveyed firms resulted in corrupt practices and dealings with the government, which firms were unwilling to disclose. The corporate governance principle is the sovereign rights of shareholders, since the boards of directors, who are to ensure that effective corporate governance prevails, are accountable to shareholders. Again, this section of the principle brings out how the size of the board should be. It states that the board's size of every corporate entity ought to be arrived at with the belief of promoting the board's effectiveness as well as ensuring appropriate representational needs. However, no specific number is set with regard to membership but goes on to mention between 8 and 16 members.

The principles of corporate governance of Ghana reflect the shareholder perspective of the Anglo-American model of corporate governance. This is because the principles reflect the sovereign rights of shareholders, since the board of directors who are considered to be the principal mechanism to ensuring effective corporate governance has to account to shareholders. In addition, the principles emphasize the traditional view where the board is regarded as representatives of shareholders. Finally, there are certain elements that determine the effectiveness of the board as a mechanism for corporate control. These elements are the composition of the board, independence of the board, the leadership structure (CEO–chairperson separation), board committees such as the audit committee and remuneration committee, and access to timely and regular information by directors

Organizational characteristics: From Table 8.1, most of the firms have been operating for the past 113 years, though some have been in existence for over 59 years. While the average age of firms is 59 years in South Africa, it is about 36 years in Ghana. On an average, these firms are employing about 9,900 staff; however, some employ over 300,000. It must be pointed out that the sizes of these firms are highly dispersed considering the minimum and maximum employment levels of 20 and 303,098, respectively, and it is clear that firms in the South African sample are larger, with a mean size of about 56,280 employees. It could also be seen that most of these organizations have heavy institutional presence, with 46 percent in South Africa representing the mean value of institutional shareholding while that of Ghana is 57 percent.

Financing issues: While most of the organizations depend on debt as against equity for financing, long-term debt relatively represents the major component of total debt in the overall sample firms in Ghana. South Africa, on the other hand, uses more of short-term debt to finance their operations. This is more surprising because South Africa with a more developed financial market is expected to have more long-term debts as compared to Ghana.

Table 8.1 Summary statistics—overall sample (observations = 388): Country-specific summary

	Mean	Std. dev.	Min.	Max.	Mean	Std. dev.	Min.	Max.
Manager characteristic								
CEO tenure	5.50	1.66	4	8+	4.22	1.48	2.00	8.00
Board characteristics								
Board size	14.32	4.31	6	23	8.39	1.81	5.00	13.00
Independence	0.59	0.22	0.05	0.85	0.24	0.11	0.09	0.4
CEO duality	0	0	0	0	0.39	0.49	0	1.00
Frequency of board	12	0.33	10	13	10.34	2.24	5.00	14.00
Audit Committee Characteristics								
Size of audit committees	5.89	1.57	3	9	4.06	0.85	3.00	5.00
Audit committees' independence	0.55	0.17	0.33	1	0.78	0.17	0.60	1.00
Frequency of meetings	4.18	0.39	4	5	5.39	1.88	4.00	10.00
Organizational characteristics								
Organizational size (employees)	56,279.59	83,498.25	800	303,098	918.33	725.78	180.00	2,500.00
Organizational age	46.11	27.32	15	113	35.72	15.76	6.00	71.00
Institutional shareholding	0.58				0.57	0.19	0.25	0.90
Organizational growth		0.72	0.01	3.35	0.32	0.29	0.01	1.36
Finance								
Leverage	0.62	0.26	0.05	0.99	0.72	0.13	0.33	0.96
Short-term leverage	0.32	0.17	0.003	0.71	0.42	0.14	0.14	0.83
Long-term leverage	0.30	0.23	0.001	0.80	0.31	0.12	0.02	0.65
Organizational performance								
Return on assets	0.18	0.14	−0.015	0.68	0.13	0.12	−0.14	0.54
Tobin's q	0.37	0.51	0.002	3.47	0.30	0.27	0.002	0.99

Source: Kyereboah-Coleman (2007).

Organizational financial performance: By comparing accounting and market-based performance measures, it seems the firms are relatively doing better on the market-based measure. While the mean value of return on assets is 0.13 in Ghana, that of Tobin's *q* is 0.30, indicating an average return on assets of 13 percent. Expectedly, firms in South Africa with a relatively developed corporate governance structure are ahead of Ghana in terms of performance.

Governance characteristics: South Africa appears to have a mean board size is 9, with a maximum of 23 directors. The standard deviation of 4.31 suggests that there is rather a wide dispersion. In the overall sample, these boards are relatively less independent as they are mostly dominated by executive directors. The mean value of 0.24 for board independence suggests that on an average about 76 percent of these boards are made up of executive directors in Ghana.

However, some of these boards could be said to be highly independent, with 85 percent of their membership being constituted of nonexecutive directors. The study shows, however, that corporate boards in South Africa is largely dependent constituted mostly by nonexecutive directors.

Most of these boards in the overall sample largely have their positions of CEO and board chair separated, with only about 19 percent of the firms whose boards have the CEO and board chair positions entrusted in the same personality. However small it may be, recent thinking has shown that the appointment of one person into these two key positions has serious repercussions for agency costs and firm performance. Situations like that generate enormous conflict of interest because decision control and decision management functions are all embedded in the same person. The King Reports clearly indicate how these two positions should be separated. Further analysis shows that in South Africa, there is a clear separation of the positions of the board chair and CEO. None of the firms in the South African sample have the positions of the board chair and CEO occupied by the same person. Thus, 39 percent of firms in the Ghanaian sample have the same person as both the CEO and board chair. It could be pointed out that there are greater conflicts of interest with regard to firms in Ghana where as much as 39 percent of sampled firms have decision control and decision management embedded in the same personality. The sample analysis shows that boards in the South African sample have rather been meeting more frequently with a mean frequency meeting of 12 times. Twelve times in the year suggest that these meetings are for problem solving and could essentially be due to corporate crisis. Boards in Ghana have a meeting frequency of about 10.

Audit committee: The audit committees of these firms have sizes ranging between 3 and 9 with a mean size of about 6 members. Indeed, the mean size of 4 is representative of Ghanaian firms. Nonexecutive directors and nonaffiliates of these organizations dominate most of these audit committees at country level. Thus, one could say that to a large extent these firms have independent audit committees. Unlike the boards, the audit committees have a mean annual meeting frequency of about 5, suggesting that the audit committees may be meeting on quarterly basis to attend to business of interest.

Solutions and Recommendations

The study showed that generally both countries practiced to reasonable extent good corporation governance. However, the following recommendations are important to enhance good governance in organizations.

First, in order to implement good corporate governance, managers need to know that they should be concerned about the interrelationships between corporate governance and firm performance. The study findings strongly confirm this correlation and therefore firms that adopt and implement good corporate governance have higher advantage of increasing their performance. More so, this will ensure that interests of the firm are served and there is easier access to funding from investors.

Secondly, there is need for the regulatory agencies in relation to corporate governance to continue enforcing and encouraging firms to adhere to the guidelines on corporate governance for financial institutions. This can be ensured through enacting more rules and regulations, thus ensuring that firms maintain confidence in shareholders and customers.

Thirdly, empirical evidence from the study that corporate governance has some influence on a firm's performance; hence, clear policy implications should not be lost. This study recommends that corporate entities should promote corporate governance to send a positive signal to potential investors.

Fourthly, this empirical findings indicate that different types of ownership structure have similar concerns on implementing good corporate governance; the findings can be used to inform the government and other regulatory agencies that they have to be more concerned over corporations with worse corporate governance practices. In addition, the regulatory agencies including the government should promote and socialize corporate governance and its relationship to firm performance across industries.

Lastly, shareholders need to know that they have an important role in ensuring that firm's management are following and implementing good corporate governance. They can do this through establishing certain control means and thus undertake the monitoring process. Furthermore, other stakeholders should play a more active role in ensuring good corporate governance in corporations.

Suggestions for Future Research

The study may have assumed that the efficient performance of firms relies on corporate governance as mentioned earlier. However, the study does not openly rule out the fact that some other variables in the environment could be critical for firm performance. Hence, future research could usefully focus on the macroeconomic conditions necessary to promote maximum performance within the developing economies.

Conclusion

The idea of this chapter was to demonstrate that corporate governance affects a firms' performance. The examples drawn in this chapter aim to raise awareness that corporate governance has potential benefits on firms' performance. Such benefits include resolving conflicts of interest, instilling controls and a sense of ethics, and enforcing and encouraging transparency. It promotes efficient use of resources, fair return for investors through better flow of funds and improved access to low-cost capital, strong internal controls and discipline, and might achieve better credit ratings that would lead to lower debt funding and higher stock price valuation, which can result in equity dilution when additional stock is floated.

Moreover from the aspects of literature review, evidence indicates that corporate governance is gaining more attention in the developing economies such as South Africa and Ghana.

Discretion on compliance should not be as broad as it is. Consideration should be given to making some current "comply-or-explain" corporate governance provisions mandatory, and to requiring shareholder approval for departure from any aspect of the corporate governance code.

To reap the benefits of the global capital markets and attract long-term capital, corporate governance practices must be credible and well understood across borders. Even if countries do not rely on foreign investments, adherence to corporate governance practices will increase the confidence of the domestic investors, reduce the cost of capital, and induce a more stable source of capital.

Countries have corporate governance differences that have created different understanding and behaviors of the board members. All these potential benefits of corporate governance have been observed and analyzed in this research, and so I can conclude that there is a positive relationship between corporate governance and performance.

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Discussion Questions/Study Questions

1. Discuss the statement that 'Certain political parties in the economic environment are known to promote and favor good corporate governance principle'.
2. What are the overarching principles of corporate governance? Discuss

Key Terms

Auditor: An auditor is a person appointed and authorized to examine accounts and accounting records, compare the charges with the vouchers, and verify balance sheet and income items. An auditor can be either an independent auditor unaffiliated with the company being audited or a captive auditor, and some are elected public officials.

Audit committee: The audit committee of the board of directors is primarily concerned with ensuring that the company's financial statements are timely, relevant, and reliable; that financial controls are adequate; that the company complies with relevant regulation; and that the internal and external auditors are fulfilling their proper roles. They are commonly responsible for recommending the selection and compensation of the external auditors.

Board committees: Board committees are subset of directors with appropriate skills to spend additional time focusing attention on their assigned subject matter. These committees, however, do not relieve the full board of its responsibility for these matters; they merely allow for specialization and help streamline the operations of the full board. The committee chairs typically present a report to the full board with the committees' recommendations on how the board can best fulfill its responsibilities.

Capital market: Capital market is the part of a financial system concerned with raising capital by dealing in shares, bonds, and other long-term investments. These markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.

Chief executive officer: A CEO is generally the most senior corporate officer or administrator in charge of managing a for-profit or nonprofit organization. An individual appointed as a CEO of a corporation, company, nonprofit, or government agency typically reports to the board of directors.

Chief executive officer duality: Chief executive officer duality refers to the situation when the chief executive officer also holds the position of the chairman of the board. The board of directors is set up to monitor managers such as the CEO on the behalf of the shareholders.

Corporate Governance: There several definitions of corporate governance, including the following: Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate governance code: The corporate governance code of a company is a document developed and approved by the board of directors, which stipulates the company's governance policies as regard to the shareholders rights, functioning of the board of directors and management, control environment, information disclosure, and transparency.

Directors: Persons serving as members of the company's board are directors. They are usually elected by voting the company's shares under rules established in the firm's organic documents. Directors have formal fiduciary duties established under relevant company and other law. If the firm is publicly listed, directors may also have additional accountability under applicable securities legislation.

Emerging Economy: An emerging economy describes a nation's economy that is progressing toward becoming more advanced, usually by means of rapid growth and industrialization. These countries experience an expanding role both in the world economy and on the political frontier.

Author's Biography

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He had his first degree in geological engineering at Kwame Nkrumah University of Science and Technology, Ghana, in 1966. He continued with his master's degree in business administration, finance at Technical University of Freiberg, Germany, in 2002. He is a chartered accountant and a member of Association of Certified Chartered Accountants. He is currently doing his PhD with Open University of Malaysia.

CHAPTER 9

Disaster Governance—Dealing with an Earthquake

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Abstract

Organizations operating in environments where natural disasters occur need to take account of governance issues when dealing with a crisis, particularly when the organization, staff, and its clients may all be affected. One organization, Pathways, which offers mental-health services, has reviewed its disaster governance during the February 2011 Christchurch earthquake. Feedback has been examined thematically in terms of strategic intention (including business continuity), human resources issues (including deployment of staff), organizational culture (including lived values), and strategic networking (including organizational politics and links with external organizations). Learnings from the earthquake include the need for responsive and visible leadership, effective information and communication systems, interagency collaboration, role clarity and boundaries, robust selection criteria, and enactment of the organizational values.

Keywords: Disaster governance, Strategic intention, Human resources, Strategic networking/interagency collaboration, Organization culture, Responsive and visible leadership, Role clarity and boundaries, Selection criteria.

The Earthquakes

New Zealand is situated in the Pacific Ring of Fire, which stretches to Asia, Alaska, and along the coasts of North and South America. This ring of volcanic and earthquake activity contains 75 percent of the world's most active and dormant volcanoes and is the area where 90 percent of the world's earthquakes occur (About Geography 2012).

On September 4, 2010, Christchurch (New Zealand's second most populated city) experienced an earthquake (magnitude 7.1) that caused damage, but little loss of life. This was followed less than six months later on February 22, 2011, by a 6.4 magnitude quake that shook the city for 12 seconds and caused 181 deaths, thousands of injuries, and damage to tens of thousands of buildings. There have been approximately 20,000 aftershocks since the first quake. It is the second major earthquake that is the focus of this study and considered the main disaster.

There are many definitions of disaster, but the second earthquake fits many of the criteria for being one: it was an unexpected and uncontrollable dangerous event (Adshead, Canterbury, and Rose 1995; Fritz 1961 as cited in Scaffa, Gerardi, Herzberg, and McCall 2005), at the interface of natural, social, and human systems (The Red Cross 2001 as cited in Kapacu 2007), which exceeded the capacity of the local community to respond (Comfort, Ko, and Zogorecki 2004), and resulted in significant disruption to the community and social structure after the event (Tierney 2000 in Rodriguez et al. 2006), as well as causing "seemingly senseless deaths and injuries" (ibid., 170).

There is still significant disruption to business, many people have not been able to return to their homes, insurance claims are still being settled, infrastructure remains disrupted in some areas, and people remain exhausted with many retraumatized by the ongoing aftershocks. While many people are resilient and recover quickly (Gluckman 2011), mental-health effects often last longer than the physical manifestations after a disaster (Fisher 1998 cited in Scaffa et al. 2005).

A survey of Christchurch business owners showed the five key issues they were facing a year after the earthquake included the following: cash-flow, loss of markets or sales, mental tiredness, building/location, and insurance/legal issues. Only 55.6 percent were in a building that was okay or required only minor repairs. However, optimism levels have increased from 26.8 percent in mid-2011 to a year later when it was at 74 percent (Rebuild Christchurch 2012). Consumer confidence has improved significantly in recent months as the rebuild of Christchurch begins to take shape (NZ Herald 2013).

The Organization

Pathways is a nongovernmental organization and part of the Wise Group, which provides both residential and community mental-health support, crisis, and planned respite services across New Zealand to more than 1,000 people. The vision is to create mental-health and wellness opportunities to enable people to live their dreams and flourish.

The Effect of the Earthquake on Pathways

At the time of the earthquake, there were 50 staff in Christchurch providing services to 120 consumers through 2 residential complexes, 2 supportive landlord complexes, mobile support services, and planned respite care. None of the staff or consumers was killed or seriously injured, but many lost property, friends, or infrastructure services. The regional office was based on the fourth floor of an office building in the central business district of Christchurch, which was the area worst affected by the quake.

Pathways had updated its regional emergency disaster plan following the September 2010 earthquake. On the day of the earthquake, staff were in the mid of a busy day: visiting people in the community or providing support to clients in residential complexes, while others were at meetings or in the regional office. Staff in the office evacuated down the stairs, which seemed to be moving away from the walls and vacated the building, leaving personal belongings and work equipment behind. No one was able to re-enter this building for five weeks and then only to retrieve some equipment. Ceilings had collapsed, glass wall panels had fallen, and furniture was toppled and destroyed. This building was ultimately "red-stickered" for demolition.

The residential complexes were not badly damaged, but staff needed to reassure clients before they could check on their own families' whereabouts. Mobile support staff ensured those they were visiting were safe and then tried to head home or to an identified response center, over roads that were in many cases destroyed or gridlocked. Telecommunication services remained mostly uninterrupted and power was restored fairly quickly. Other infrastructure was disrupted with no water available at any of the remaining Pathways' service complexes.

Of critical importance was the pre- and postearthquake vulnerability of the clients and the need for continuity of business to ensure ongoing support and recovery. Vulnerable and already traumatized clients had just been retraumatized by the disaster. Gluckman (2011) notes that there are psychosocial effects for those going through an earthquake—both individual psychological effects impacting on how people feel and social effects impacting on how they relate to each other (p. 1). Staff were likely to be experiencing these impacts too.

Continuity of service during the crisis along with the need to provide support and human resources services to the staff affected were critical disaster governance issues for Pathways.

Disaster Governance

Governance can be defined as the process of steering, guiding, and correcting in an NGO (Wyatt 2004). It is the provision of overall vision, direction, purpose, and oversight to ensure an organization's efficiency, effectiveness, and focus are maintained. Well-functioning governance structures identify the mission, articulate the strategy to achieve organizational goals, evaluate progress, oversee the financial affairs of the organization, support the organization's long-term viability, promote organizational continuity and stability, and serve as a link to the organization's constituencies (The Working Group on NGO Governance in Central & Eastern

Europe 2011). However, as Tierney (2012) points out, disaster governance is an emerging concept closely related to risk and environmental governance, and it may require more collaborative governance focused on public purpose to reduce impacts and losses. Many leaders focus only on communications and public relations during a crisis, but it is essential for them not only to make sense of the issues, sell changes, remain agile and creative, make decisions, and take risks, but also to ensure appropriate governance issues are addressed. These include strategic business survival, leadership, resourcing, infrastructure, ethical, and safety issues.

During disasters, leaders may need to use a different frame through which to view governance and their own roles, to develop appropriate processes, and to provide a roadmap for decision making. The different lenses through which to view the governance issues of handling a disaster are considered in this case as being that of strategic design (for organization continuity), human resource management practices (to achieve organization strategy and goals) and organization culture (to link to organization mission and values), and strategic networking (dealing with organizational and interagency politics and building links to other stakeholders) (Wooten 2007).

Following Wooten's (2007, 2008) four lenses, in terms of *strategic design*, leaders need to consider the impact on the business in the future and how it might continue to operate, how to allocate staff from other areas to assist in the disaster area, and how to continue to manage successfully in under-resourced areas. Through a *human resources* lens, there is a need to be aware of the organization' social and human capital, consider the gap between the employees' needs and the organization's goals and assess the impact of potential labor shortages, while at the same time scanning the environment for further threats. *Organization culture* can be destroyed or enhanced by the way leaders deal with a crisis, so role modeling by leaders is key to the outcome, as the leaders may need to both walk the talk of organizational values and also challenge any cultural barriers during the crisis. In relation to *strategic networking*, the leaders need to develop networks both in and outside of the disaster area to assist with the crisis and ensure that those who volunteer for assistance are able to cope with the crisis, while taking note of key power brokers within and outside the organization who can facilitate the process.

While this particular type of disaster may not be one that will affect most organizations, the Institute for Crisis Management points out that between 2000 and 2009 there were 90,000 news reports of business crises in the United States alone. Learnings from this case study may apply to other situations in which a business crisis occurs and disaster governance needs to be implemented.

Data Collection

After the initial crisis of the earthquake, leaders and staff were interviewed and completed questionnaires to debrief and reflect on the disaster and to consider both how the organization had handled the crisis, what it did well in terms of disaster governance issues, and what it might have done differently or better. Responses were thematically analyzed.

Strategic Design

From a strategic design perspective, demonstrable leadership to enable continuity of business was a key driver. The then CEO and general manager of Pathways were aware of the disaster within five minutes of the quake occurring. Both had arrived in Christchurch the day after the February 2011 earthquake to accommodation arranged after the first earthquake in September 2010 and coordinated the disaster response for the next three weeks from within the city. From then on they were intermittently present there for a number of months.

In the immediate aftermath of hearing about the earthquake, the first issue was to establish the health and safety of all Christchurch staff and clients. They were contacted by phone to establish their well-being and immediate needs. Phone lists and the task of topping up credit on phones were allocated to each staff member in the head office. After the first earthquake, all clients had been provided with prepaid phones with support from Telecom NZ. In addition, e-texts could be sent by computer. This enabled 70 percent of staff and clients to be contacted by the end of day one.

Then from a governance perspective, creating a structure to deal with the disaster was essential. Volunteers from staff around the country were sought to provide support to the Christchurch staff, who needed time to organize their families and homes. By the end of the day following the earthquake, 10 volunteers had been identified, were booked on flights, and had accommodation organized. All of them were accompanied by supplies of water, hand sanitizer, and other resources needed to supplement supplies in Christchurch.

Over the next 6 weeks, a total of 31 staff were sent to provide moral and practical support to the organization in Christchurch so that practical staffing levels could be maintained, staff could take leave to deal with anxiety/trauma responses, and practical issues such as accommodation and safety of their families. All of the staff from other regions brought boxes of bottled water and other supplies.

Managers in most other regions considered that they were able to cope with the cover of their own services and those of Christchurch during this period, without impeding client needs significantly. The Christchurch managers felt the most valuable outcome was that they were able to take in staff from the regions "quickly with the right people . . . able to step in."

There was some impact on the regions' ability to deliver services, but the managers had taken this into account when making selections. Some permanent staff took on extra shifts or worked in different parts of the service and they also utilized casual staff more fully.

In terms of access to clients, one landlord complex was within the police cordon that was established around the seriously damaged central business district. It required permits and entry via army and police roadblocks to enable services to be delivered to clients within the cordon. Leaders facilitated this as much as they were able to by ensuring that police and army were aware that they were providing health care to vulnerable clients.

The decision was made to consolidate the two residential services to one complex, and this was made possible by having some vacancies and enabling clients to share flats. There were no toilet facilities for days and in some cases for weeks. For many staff, the role became more basic in that they needed to assist clients with using plastic bags for human waste disposal and then burying these in gardens. Infection control was a key issue.

From a business continuity perspective, resources to enable the organization to continue functioning were also a significant requirement. The two leaders had taken a large amount of cash with them to enable them to purchase the necessary goods, as they expected that automated cash machines would not be working. Extra money was also transferred into the bank accounts of two senior staff to enable the purchase of resources. There was a continual need to provide other basics such as water, food, medication, sanitary supplies, chemical toilets, buckets, solar showers, radios, batteries, torches, and access to Red Cross emergency grants. Within two days, a pharmacist was making up blister packs of medication for clients.

Staff needed to be able to travel to see their clients, and with three company cars trapped inside the cordon, five rental vehicles needed to be hired on the day following the earthquake.

Strategic Design Feedback

In terms of keeping the organization functioning, staff valued out of town staff coming to assist. This provided them with practical support in times when they could not cope and moral support, in which the organization felt like a "family and present with us."

Practical resources became crucial for on-going business and staff commented how they did not have to worry about the provisioning of items such as water, food, four-wheel drive vehicles, and chemical toilets, as they were available quickly. On the other hand, there was inevitably an oversupply of some goods, resulting in some resources continuing to be available should there be a future need.

The quick decision on a base for the mobile team gave stability to the team, as did the ability to have storage and resources available. More than three days of food and water in a survival kit became an obvious need.

The documented regional disaster plan (which had been updated six months prior) was not accessed or followed, but nevertheless the leaders felt that all elements of a sound disaster response could be followed. People do follow a common sense model on the ground.

Human Resources

Staffing requirements to maintain continuity of service was a key issue. Some Christchurch staff took annual leave to deal with the aftermath, and others left the city altogether. Some needed time off to sort out personal affairs or to deal with their emotions. Many of the clients went to stay with family or friends elsewhere, which eased the pressure on staff, but, on the other hand, time to do tasks increased and mobile staff found driving round the city difficult, as journeys that previously took 10 minutes could take an hour or more.

Staff from out of town were redeployed to Christchurch on a voluntary basis. They needed to be accommodated, have communication facilities, be orientated to the situation, be briefed on the role, and maintain touch with their families and regular work colleagues.

The most common criterion for managers to select staff to go to Christchurch was first their likely calming influence or ability to remain calm under stressful conditions. The next most important criteria were the knowledge of the organization, those who had the "whatever it takes" attitude and those with specific skills to offer (e.g., nursing). Further criteria included those who had assisted in the previous earthquake in September the year prior and the necessary makeup of the team to deliver the services required in a postearthquake situation.

In addition, the need for debriefing of the critical event was important. People needed time to connect with others, to talk about what had happened and their feelings. Employee Assistance Program services were available to all staff. Some of the out of town staff were experienced in dealing with posttraumatic stress and provided psychological first aid. Many other staff around the country were stressed or grieving due to what had happened and similar services needed to be provided to them. Shared morning teas in branches were held. TVs in staffrooms had to be turned off as staff became so distressed at the ongoing footage. All staff across the country participated in the 2-minute silence one week after the earthquake.

Financial dilemmas were another issue. Staff were naturally concerned about costs of caring for other family members, additional petrol costs to get to work due to road closures, the cost of not being at work (some because child care facilities and schools were closed), and some were dealing with destruction of their property. The organization gave them an additional cash payment into their accounts.

Change management became a critical governance issue. Staff had to deal with changes in structures of teams, changes in venue, changes in their home circumstances, changes in client needs, and changes in service delivery.

Human Resources Feedback

From a human resources perspective, staff appreciated the practical, financial, and work-related support they received. Staff valued the practical support offered to them by the organization. This included phone calls, texts, credit on mobile phones, and relief payment. "$500 in the pocket to buy groceries—I had to queue for an hour, but I've never bought that many groceries in my life" said one.

In addition, the time off granted to attend personal affairs or simply to reflect on the momentous event was important. Just being able to go and sit under a tree for a while became an essential part of coping. Those who were able to continue with work felt significant pride in being able to do so. For those working on their own, the need to set expectations about how long this might endure was noted.

Regarding staff flown in to assist, those who had previously traveled to the Christchurch region were particularly well regarded due to familiarity with the situation and staff. People with the right level of respect and ability to step back were important. Practical skills that were valued included nursing, camping, and proactiveness. Some felt that not all staff that volunteered had the right level of respect and at times felt overtaken or that there were too many out of town staff.

Strategic human resources planning postdisaster is key as there were times when out of town staff were rostered into Christchurch only for a week resulting in "short changeovers" of staff. Rostering needs to be managed by one or two people to ensure that rosters are well managed. Issues related to child care, with schools and day care centers closed, need to be considered. It was difficult for some staff to be at work or focus on work, while these issues remained unresolved.

Orientation to the situation varied in quality and comprehensiveness, with 16 out of the 31 feeling they had received some orientation and had some idea of what to expect. The quality often depended on who provided the orientation at the time. The suggestion was that the national team needed to coordinate the orientation, ensure there was written documentation, and that a more structured process be used, so that all receive a standardized and consistent briefing.

Clarity of roles was raised as an issue and it is essential for clear communication about who is responsible for what in a postdisaster situation. This also impacts on the issue of rostering and coordination of resources including vehicles.

A better selection process for those who volunteered to assist is necessary. Skills that could be considered include proactivity, emotional intelligence, initiative, judgment, and decision making. There is also a need to have good logistics in bringing in out-of-towners to a disaster situation and to orientate these staff better to the situation.

The value of having up-to-date information about clients and staff via centralized information systems enabled better staff and client planning.

Organization Culture

Communication and role modeling of values by leaders was a key element of disaster governance. The values of the organization are as follows: caring, optimism, passion, innovation, integrity, fun, imagination, and courage. The spirit statement is "whatever it takes" and "think and act as one." All of these needed to be reinforced in the way every activity was carried out.

Communication had to be transparent, open, and accurate. For the first 48 hours, the full communications team was dedicated to communication about the quake and its aftermath. Information needed to be factual, objective, and up to date. From then on, they focused on ensuring continuing information flow. This included details such as availability or locality of a community laundry, road closures, and welfare centers in Christchurch, as well as updates for all staff on the intranet and a resource bank with an "I can help" address for people to offer skills (such as plumbing) and support. A message board was established so that people could express their emotion and the organization could show it cared and was actively doing things to address the problems of staff. The chief executive (CE) and general manager (GM) also wrote regular reports back to the organization.

Communication was a key factor in the response and a coordinated and comprehensive communications strategy evolved to support all the regions. Early communication about the chain of command, health records of clients, and state of other staff and clients contributed to the positive postquake culture.

In line with the value of "caring," when staff indicated that they never wished to go back to the fourth-floor office where they had been when the quake occurred, the decision was made to relocate even though this created significant financial liability in terms of the existing lease. A single-story building was located and within a month it was opened.

In addition, the immediate presence of calm and considered leadership and visible governance played a key role "they were right there and then, not a week, but the next day." Having the CE and GM present created a sense of safety and leadership. Managers generally appreciated the immediate responses they were given to requests. They were able to interact with the leaders to "think and act as one." Daily meetings and the ability of leaders from outside of Christchurch grounded stressed staff and clients.

In line with the spirit statement of "whatever it takes," no one quibbled about the work not being their job during the disaster and most people simply asked what they could do to help. Dealing with "stressed and fractious people" was not always easy and staff recognized the need to be gentle and understanding. Knowing that one could leave the area while others could not also left some leaders with the need to brief staff both remaining in the disaster zone and those returning to regions, on the difficulties of returning to day-to-day life.

Organization Culture Feedback

Leaders recognized that there was value in being on the ground and going through the experience with staff and how difficult it is to make decisions remotely. Leadership flexibility enabled staff to get on with it. " I recall (leaders) saying yes to it, whatever it is you want, it's all about yes. . ." This included leaders delaying competency assessments and the introduction of a new electronic health-record system, so that workers' stress levels were not increased.

Staff would have liked more one-on-one discussions about how they were coping. A key time is 4–6 weeks after the earthquake, when adrenalin reduces and stress set in. Their first response is family and home, rather than work, and it is crucial for work organizations to recognize that this is their first response call.

On the other hand, communication at times was perceived as giving mixed messages, with an identified need for more written communication to support verbal messages, when people are under stress.

The nature of the duties varied, but volunteers mainly provided support to other staff, covered shifts, or took on additional support roles with clients. Many also had to cope with the fear that the aftershocks generated and four found the visual damage to the city had an impact. There is a need to ensure that staff who may experience vicarious traumatization are supported. About 59 percent of the out-of-town staff had postdisaster debriefing on return to their region. Others did not, but of those who did not, many felt that talking to friends, colleagues, and family was adequate.

For 8 people the most memorable experience was the opportunity to work with others and the team bond that formed, while for 7 others it was an opportunity to be in a support role to colleagues and the appreciation they received. There was strong acknowledgment of the leaders' "whatever it takes" approach. Staff felt proud that the out of towners, for example, had invited them to come and take showers at their motels and if need be to spend some time there to get away from the stress of daily life. About 17 staff identified that postvolunteering they had received written appreciation or personal expression of thanks for their contribution.

About 60 percent of the managers felt the communication they received from leaders and the website information was useful, and the rest felt they would have appreciated a midcycle briefing to enable better understanding of needs. Staff found the website handy for offering their support. One found the amount of information provided was overwhelming.

In general, however, communication, problem solving, and organizational values being lived out were key positives during the disaster. The managers acknowledged that for the staff who had assisted in the Christchurch quake, this had been a significant learning and that they felt privileged to play a part.

The managers felt that the responsiveness of the organization and the speed of response was the most significant positive outcome. Managers also identified the need for the organization to reflect on the experience of people in Christchurch to be better prepared for governance issues during a disaster.

Strategic Networking

Strategic networking became essential to business continuity. Various network contacts made useful contributions to business continuity. Tiki Wine, contacted through one of Pathway's staff, brought in a trailer with two large pods of clean water three days after the quake. This enabled water bottles to be refilled. Air New Zealand offered to fly in 12 laptop computers and data cards, as staff's personal luggage and consistently permitted extra baggage to go on board free of charge. Supplier relationships with the rental company, Leaseplan, enabled hired vehicles to be upgraded to four-wheel drive vehicles at a favorable price, so that staff could navigate through congested and broken roads, some filled with liquefaction. Another employee had a contact with a cruise ship and they sent large boxes of linen that was distributed to people.

Powerful players intervened. The chief financial officer arrived in a van filled with chemical toilets, food, bottled water, a generator, toilet tents, cell-phone chargers, water filters, and purification tablets. A garage with supplies was set up to become the local store—named after the CE.

The local district health board ensured that all displaced services could share space and resources and could facilitate effective referral processes.

Regional managers offered to release staff who volunteered, putting extra pressure on their regions.

Strategic Networking Feedback

When the district health board implemented a new referral system, this was implemented quite rapidly and it was often difficult to cope with the new influx of clients. In addition, while the internal health-record system implementation was delayed by 6 weeks, staff still felt that this added to the numerous life and work changes they had to deal with. It was a challenging time to cope with further change.

There was some perceived resentment by a few Christchurch staff that staff from other regions had come in and "taken over" their roles or had questioned how they did things. In most cases, managers made sure their own services were sustainable, while recognizing the significant need within Christchurch. Managers were generous with key and senior people, which required additional work from them within their own regions.

In some regions, networks of not-for-profit providers banded together to identify how they could support those providers within the regions. Offers of staffing and practical supports were made. Little uptake was made of staffing offers, as it was identified that inducting new people into an organization's systems and processes at a time of high pressure was "more trouble than it's worth" by some Christchurch providers. Fear of loss of jobs and turf protection may have played some role in the lack of interagency collaboration.

Key Disaster Governance Learnings

Strategic Design

Disaster governance requires some unusual roles from the CEO and board. Far more than PR is required in maintaining business continuity and client service, especially when clients are vulnerable. The practicalities of basic survival needs (medication, toilets, water, lighting, power, phones, cash, and transport) and posttrauma support interventions are of course important. But beyond this, leadership needs to demonstrate strength, resilience, and presence in the face of a disaster. This needs to be supplemented with centralized communication and information systems to enable deployment of appropriate resources and personnel. The organization realized that it had additional capacity in all but one region, and this suggests that the organization could cope with a more extreme disaster should this ever occur. The strong infrastructure, size, and strength within a mental-health and governance group, the Wise Group, facilitated its ability to respond. Because staff are deployed around the country, staff from other regions were able to be sent to Christchurch at short notice without significant compromise to service delivery. Many other service organizations that lost both buildings and technology struggled to cope, when staff were unable to be at work, but interestingly did not take up offers of assistance.

From a health and safety perspective, there is a need to move from a prescriptive emergency plan to one based on broad principles and guidelines, which are in line with the values and culture of the organization. Additional food and water has been added to emergency kits. The ongoing challenges Christchurch staff and clients face, with some homes still not being categorized for demolition or repair, ongoing aftershocks, and significant financial losses, mean that staff need continuing support almost 3 years after the disaster.

Business continuity insurance meant that resources could be used to purchase necessary resources and provide adequate financial reserves. In addition, the foresight of leaders to bring large amounts of cash (a learning from the first earthquake) facilitated business continuity.

Telecommunications was possible during the disaster and this made a difference to the ability to access immediate and ongoing information about the situation. It also offers the opportunity to curate, test, and train for mobile technology apps to enable better internal and interagency collaboration to meet challenges and deal with the complexity of disaster governance. Such apps could enable search, location, rescue, and management of resource allocation.

In this case, electricity supply was restored to the sites quickly and air transport was restored by the day following the earthquake, but strategic plans for the future need to consider how to handle a disaster where these major infrastructure resources are not available and these factors need to be mitigated.

Human Resources

The psychological aftermath is significant and there are ongoing tensions between different agendas (Gluckman 2011). People feel fatigued and traumatized by the ongoing battles with bureaucracy, insurers, and the Earthquake Commission. "There is a need for ongoing human and organizational resources" (ibid, p. 8). Employee Assistance Program sessions traditionally of three free sessions are probably inadequate to deal with the aftereffects of a significant disaster. The Wise Group was able to open its Women's Wellness Centre in another location to families from Christchurch to give them a break for a week from the Christchurch scenario.

In this environment, it is also essential to ensure people with the right skills are selected to assist in the process of dealing with a disaster.

Selection criteria include not only a "can do" attitude, but also the ability to communicate sensitively and clearly. The ability to offer practical support and not undermine current formal leadership roles is also key. Rostering processes need to be sensitive not only to those coming to help, but also to those whose jobs they are doing.

Orientation to role and situation and socialization into the disaster context needs to be standardized, coordinated, and documented, so that everyone gets the same briefing with regular updates to all.

It may be necessary to ensure that all who volunteer get access to formal debriefing, although some may choose to use their personal network to download their experiences of being in a disaster area.

Organization Culture

Leaders and managers living out organizational values together were significant. The leaders demonstrated this not only by being present for a lengthy period during the initial crisis, but also by ensuring that the "whatever it takes" and "think and act as one" values were visibly demonstrated through accessibility, responsiveness, and presence. This ensured effective decision making, moral, and practical support was available when it was needed and created a sense of stability and confidence in staff. The division between operations and governance is not feasible during a disaster.

While the communication strategy generally worked well, using both personal briefings by leaders, communication from head office, Internet feedback, and visible ongoing support, there is a need to streamline the communication, taking into account people's psychological state at the time.

Communication issues appeared to arise during the time leaders were not on the ground in Christchurch after the first 6 week, suggesting that an ongoing active engagement by the CEO and GM is required for some extended period postdisaster.

Organization Politics

The organization did contact other providers during the disaster and offer support, but there was no response to this offer. Politics, patch protection, and the complexity of the situation may have played a role in this lack of interagency collaboration.

There was, however, ongoing collaboration with three other larger mental-health providers in the region and with the local district health board mental-health service staff to establish a more efficient referral process.

Nongovernmental organizations (NGOs) outside the region also coordinated a support response, but there were few takers and other NGOs either did not or were unable to bring in staff from other regions. There was an opportunity for Pathways staff to provide broader based services during their client visits. This suggests that during a disaster the broader coordination of human resources is required and means that Pathways needs to be lobbying now to establish this broader base so that other organizations feel as supported as this organization did during a disaster. Some work on building collaborative responses across the sector in disaster situations would be in the public interest.

Conclusion

Governance is put under significant strain during a disaster. Disaster governance may mean that the CEO/board needs to be on the ground, enabling governance issues to evolve to meet the external and social requirements so that business continuity can be maintained. The ability of an organization to respond quickly, sensitively, and appropriately to the needs of clients, staff, and managers is key. Leadership and resources need to be deployed urgently, and there is an ongoing need for effective and accurate communication. Of particular importance, where vulnerable clients are at risk, is the access to accurate information regarding needs, medications, and contact details.

This organization within the Pacific Ring of Fire was well prepared for the disaster, particularly following the first earthquake six months prior, but one wonders how many other organizations in regions where natural disasters are prone to occur have the governance capability to enable similar response? One also needs to consider what might have happened had the disaster been national rather than regionally based? Governance planning needs to incorporate a strategic intention to maintain business continuity, to have visible and responsive leadership on the ground, to have clear selection criteria and role descriptions for stand-in staff, to clarify the boundaries between those staff and the incumbents, to have a standardized orientation process, to provide written instructions where possible for people under stress, to live out the values of the organization, to ensure robust debriefing processes are undertaken, to maintain leaders' presence in the disaster zone for longer periods, and to create effective networks with any organization or individuals who may be able to assist with resources or processes.

This research provided the opportunity for staff and management to reflect on the events, to learn from what occurred, and to consider what they might do differently should another disaster event occur. People valued this process and some double-loop learning reflection process needs to be built into the postdisaster communication process.

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Additional Reading

See crisis communications plan steps during disasters at:

Ready.gov (2012). Crisis Communications Plan I& IT Recovery Plan.

http://www.ready.gov/business/implementation/continuity retrieved 1 May 2014.

Consider other types of disasters (natural or man-made that could affect the viability of your organization and impact on digital communication) at:

International Economic Development Council. Restore your economy.org

http://restoreyoureconomy.org/disaster-overview/types-of-disasters/ retrieved 1 May 2014.

Case Study Questions

1. In this case, the CEO became quite operational in the face of a disaster:
   a. Why do you think this was necessary?
   b. Could there have been other ways to handle the situation?

   c. What does governance accountability mean in this case?
   d. How does disaster governance differ from regular governance issues?
2. How was the mission of the organization safeguarded?
3. How was responsible resource management and mobilization exercised?
4. If NGOs need to be responsive to the communities they serve, how were organization and community interests integrated in this case?
5. How could public interest have been better served?
6. Should organizations have a disaster management plan that deals with all crises? If so, what does it need to include?
7. In terms of governance, how can organizations document learnings from an event like this so that the knowledge is captured?
8. If a disaster like this were to happen in your organization, what governance issues would be likely to arise?
9. How can organizations best prepare for such emergencies in the future?
10. What political factors may have played a role in lack of interagency collaboration?
11. What political factors might impact on interagency collaboration in your organization in the face of a disaster?
12. Assuming the organization did not have access to digital technology, how might the response to the disaster differ?

Group Discussion

Instructions

Divide into groups of 4–8 and discuss:

You are the board of a manufacturing organization, with 10 sites across the country and during a board meeting, you receive a text message that there has been significant regional damage due to flash flooding, which has affected one major manufacturing site belonging to the company and where 500 staff are employed. Some staff and customers who were on site are missing, there has been widespread destruction to facilities and equipment, infrastructure has been damaged, and there is a prediction that there could be further flooding in the region. It is unclear to what extent worker's homes have been damaged, but you are aware that many of them live in the area surrounding the manufacturing site and are therefore likely to have been impacted. This site is responsible for producing multimillion-dollar equipment for a major government project and at the time of the flood was slightly behind deadline on delivery. Other sites are currently working at capacity, but the flooded site is the biggest and responsible for 30 percent of the company's profit. None of the other sites have identical machinery to produce the government equipment. The company's mission is to be the customer-recognized leader in providing manufacturing solutions by producing high quality, competitively priced, short lead time, and reliably delivered products through an exceptional workforce trained, empowered to continuously improve and create shareholder value. The company has developed from a small manufacturing business to a multimillion-dollar enterprise, but it attempts to retain some family values including those of respect, leadership, innovation, and teamwork.

1. What would the board's first priority be? Justify your answer.
2. What five immediate actions would be taken? Justify your answer.
3. How would you deal with the need to maintain business continuity?
4. How do you see the role of the board members in dealing with this disaster?
5. How would you live out the mission of the organization in this response?
6. How would you live out the values in your response?
7. Which stakeholders would it be important to engage in collaboration?
8. How would you create a collaborative process with other stakeholders in the region and nationwide?
9. What policies would you develop to ensure that organizational politics and power issues are being handled effectively?
10. What would you advise the government department waiting on output from the damaged plant?
11. What digital strategies would enable you to respond better to the disaster, assuming that power, Internet, and phones are available within two days of the flooding?

Authors Biographies

Colleen Rigby holds a PhD in psychology and is a senior fellow for Corporate and Executive Education, Waikato Management School, the University of Waikato, in Hamilton New Zealand, where she runs leadership clinics for MBA students and teaches on topics related to organizational behavior, such as high-performing teams, conflict, and negotiation. She also operates a private psychological practice, consulting to various organizations. Her background includes working in industry and commerce in human resource development and being a regional director for Ernst & Young in organizational management of change. Colleen has lectured in six countries and has presented papers at various international conferences in South Africa, Canada, New Zealand, and the United States. Her research interests include leadership, conflict, negotiation, ethics, communication, and innovative teams.

Lyndsay holds an MBA from the University of Waikato in New Zealand. She started out as an occupational therapist and then moved into management and leadership roles. She was previously the CE of Pathways Health Limited and currently holds the role of portfolio manager for Mental Health and Addictions at the organization First Do No Harm (Northern Regional Alliance) based in Auckland, New Zealand. Lyndsay was the general manager of Wise Group at the time the earthquake took place and has specific insight into what occurred and how disaster governance needed to be established quickly, particularly with a vulnerable client group. Lyndsay has specific interests in strategic planning, change management, leadership development, and stakeholder engagement in the field of mental-health organizations.

Key Terms Defined

Disaster governance: Steering an organization through a natural disaster so that the organization survives and stakeholders' needs are met.

Strategic intention: Having a clear strategic direction in the aftermath of the disaster.

Human resources: Being able to allocate appropriate staff to the right place.

Strategic networking/interagency collaboration: Creating links to key stakeholders for the purposes of collaboration and shared resources.

Organization culture: The way the organization operationalizes its stated values.

Responsive and visible leadership: Leaders being available to employees and creating a sense of unity and caring in the aftermath of the disaster.

Role clarity and boundaries: Clearly defining who is responsible for what and where each role begins and ends.

Selection criteria: The factors that would enable specific people to be successful in a role in the wake of a disaster.

Organization values: What the organization purports to stand for.

Enactment of organization values: the leaders and others behave in ways that are congruent with the stated values.

Effective communication and information systems: ensuring that people involved in obtain the information they need when they need it, using whatever resources (including information technology systems) are available at the time of the crisis.

CHAPTER 10

The Role of Corporate Governance in Business Performance in Ghana

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Abstract

The purpose of this chapter is to investigate factors that influence corporate governance issues in Africa and Ghana in particular. Good corporate governance is a key part of any organization that has and wants to maintain confidence, integrity, and efficiency for its stakeholders. It is also the basis to attract and retain best skilled human capital and financial capital on a sustained long-term basis. For this reason, it is important that good corporate governance not only is driven by compliance or regulatory requirements, but very importantly is also seen as a means by which nations, public and private sector companies, and indeed all economies can improve performance, competitiveness, and sustainability. This study seeks to demonstrate how corporate governance activities have influenced business success and how business success can be maintained through good governance in Ghana. It also seeks to ascertain and document how regulation can help shape governance issues in industry. Lastly, this study seeks to determine the extent to which nature and content of governance actions in Africa differ from Western and other economies in the world.

The study used a sample of companies listed in Ghana Stock Exchange (GSE) index and the Ghana Club 100 database, an annual ranking of the most prestigious firms in Ghana. The study adopted a focus group exploratory approach in reviewing the corporate governance and business performance issues from the perspectives of regulations and performance of the top firms in Ghana. The respondents were MBA students from Central University College. All the students were workers, with some working in the Ghana Club 100.

The key findings of the study indicated that there is a perception that both local and foreign companies are familiar with the concept of Corporate Social Responsibility (CSR). These companies are indeed compliant with corporate governance issues and its effects on business success. Foreign companies are seen as more strategic and more ethical in their approach to corporate governance. Foreign firms appear to demonstrate a better grasp of the various dimensions of Corporate Governance than local firms and hence have developed a strategic competitive advantage. Good governance leads to better investor confidence.

Future research might lead to the development of an African corporate governance and business performance relationship typology for Africa and Ghanaian firms and an investigation of the relationship between good corporate governance and performance of firms in Africa.

Findings in this study carried out in the area of corporate governance and business performance will interest academics and governance practitioners working in the area of corporate governance. Empirical evidence provided on the relationship between good governance and business performance in Africa strengthens the argument for strong adherence to good governance in Africa.

These findings can help to improve on national and institutional corporate governance regulations and policy development to help achieve a national development agenda.Policy makers can use this information to help formulate policies for sustainable corporate governance development in Africa.

Keywords: corporate governance, business performance, Ghana, companies, regulations, performance.

Introduction

Governance is all about leadership, and from time immemorial, leadership has shaped the success and failure of societies and nations**.** The concept of corporate governance has a long history. In the ancient times, when humans roamed on this earth in tribes, there were tribal communes in existence. The tribal communes emerged to ensure adherence of tribal norms and supervise the activities of the tribe as well as individual members. Over a period, the tribal form gave rise to agrarian communities where the concept of family took hold. The family had a structure based on age and experience, and the family councils observed the activities of the family members. In the Roman Empire, specific corporate frames, such as municipal bodies, were developed to manage public affairs with transparency for common good. In the Middle East, the nomadic tribes had their councils to ensure fair play and justice. The evolution of Christianity and Islam in the Middle East placed the responsibility of governance on religions. The Church and the Mullahs were the torchbearers of the concept and practice of governance. In ancient India, the ruling emperors decided the concept and practice of governance.

From the book *Corporate Governance Matters*, it reads, "corporate governance has become a well-discussed and controversial topic in both the popular and business press. Newspapers produce detailed accounts of corporate fraud, accounting scandals, insider trading, excessive compensation, and other perceived organizational failures—many of which culminate in lawsuits, resignations, and bankruptcy."

Governance maybe perceived as either good or bad. The notion of "governance" is neutral. How governance is applied can be either good or bad or a mix! Good corporate governance supports effective decision making that is governed by the following:

- a well-balanced accountability framework that is based on clear communication and understanding across the organization and understanding across the organization of roles and responsibilities;
- robust performance, financial risk, and information management systems; and
- high standards of conduct.

Governance—is the manner in which power is exercised in the management of economic and social resources for sustainable human development—has assumed critical importance in these days of political pluralism. It is a vital ingredient in the maintenance of a dynamic balance between the need for order and equality in society, the efficient production and delivery of goods and services, accountability in the use of power, the protection of human rights and freedoms, and the maintenance of an organized corporate framework within which each citizen can contribute fully toward finding innovative solutions to common problems.

It is generally believed that organizations with good corporate governance have the capacity to maintain high-quality services and to deliver improvement. However, poor governance arrangements can set the framework within which the organizational systems and processes may fail to detect and anticipate serious service and financial failures.

From the earlier discussion, the question then emerges as to the link between governance and corporate governance. The complexity of governance is difficult to capture in a simple definition. The need for governance exists anytime a group of people comes together to accomplish an end. Although the governance literature proposes several definitions, most rest on three dimensions: authority, decision taking, and accountability. According to the Institute of Governance,

> Our working definition of governance reflects these dimensions:
>
> Governance determines who has power, which makes decisions, how other players make their voice heard and how account is rendered. Governance is concerned with the processes, systems, practices and procedures—the formal and informal rules—that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. Essentially, governance addresses the leadership role in the institutional framework.
>
> Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission.

However, according to an article by the Report of the Committee on Financial Aspects of Corporate Governance (the UK Cadbury Code 1992), "Corporate governance is the system by which companies are directed and controlled." "The debate on the role of boards in the wake of the financial crisis has created a lot of hype and rhetoric about corporate governance," says David Larcker. David further says, many so-called experts are heavy on opinions about governance, but light on the facts. David is James Irvin Miller professor of accounting and director of the *Corporate Governance Research Program* at the Stanford Graduate School of Business and coauthored with Brian Tayan of the new book *Corporate Governance Matters* (FT Press).

Literature Review

History of Corporate Governance

The treatise on economic administration, Arthashastra, written roughly 315 years before Christ, developed a complete structure of governance in a kingdom with clear demarcation of authority, responsibility, and accountability. The idea of governance at the level of government is ancient. Chaucer (c. 1343–1400), an English writer, philosopher, and courtier, wrote of governance. Nevertheless, the phrase corporate governance did not come into regular use until the 1980s. However, it has quickly adopted worldwide. In 1988, Cochran and Wartick published an annotated bibliography of corporate governance publications; it had 74 pages. Today, Google accesses over 12 million references to corporate governance and Bing 23 million. Research into corporate governance also began to develop in the late 1980s. Although the theoretical exploration of the subject is relatively new, the practice of corporate governance is as old as trade. Shakespeare (1564–1616) understood the problem. In his play "The Merchant of Venice," Antonio, the merchant agonized as he watched his ships sail out of sight, having entrusted his fortune to others. With a sole trader or a small-family firm, there is seldom any real separation between management and governance; changes in strategic direction merge with the day-to-day running of business.

In medieval Europe, guilds for each trade, such as weavers, tailors, and wheelwrights, enforced standards, regulated prices, and controlled training and entry to their trade. Charters or similar legal processes by cities or states incorporated guilds. Only masters of the trade could be members of the guild and only guild members could practice that trade. It is noteworthy that guild members elected the guild's governing body.

Corporations, or companies, began to emerge under charters granted by monarchs or governments to undertake operations that were potentially risky and/or highly expensive, which individuals were therefore unlikely to undertake on their own—particularly if there might be no limit to their potential losses if the venture were to fail.

By the 17th century, economic political and military competition was growing between the empires of Britain, Holland, Portugal, and Spain. Companies, created by the charter from the monarch or the state, pursued trading interests under rules set by the charter. In 1600, England's Queen Elizabeth I granted a royal charter to the East India Company, giving it a monopoly over all trade between England and Asia. The company was a joint stock company, with over 1,000 stockholders, who elected a governing board of 24 directors each year. The company traded principally with India and China in cotton, silk, tea, and opium, at one time administering parts of the British India Empire with a private army. The Dutch East India Company was granted a charter by the Republic of the Netherlands in 1602 to run Dutch colonies and to trade with Asia. The Dutch West India Company chartered in 1621 to run the slave trade between Africa, the Caribbean, and North America. The Hudson Bay Company received its royal charter in 1670, when Prince Rupert, cousin of King Charles II, saw the opportunity for fur trading in the Hudson Bay area of what is now Canada. In the Far East, Japan and China also placed the governance in the hands of their kings. In the post-Christ period, with improved navigation and availability of vessels, the traders from Europe, especially the Portuguese and the Dutch, explored the known expanse of the earth and gave rise to global trading entities reporting to the kings.

This was the beginning of corporate governance. As the approach of the 16th century, the most powerful trading nation of the time, England, formed a variety of regulations and regulatory authorities such as joint stock companies and Bank of England to govern all trading activities on a platform of accountability, efficiency, effectiveness, and stakeholders' satisfaction. The concept of corporate governance was the basic platform for these regulations and regulatory authorities, and over a period, the concept and its practice took a firm root for all activities.

From the aforementioned discussion, a corporation may be defined as "a large company authorized to act as a single entity and recognized as such in law." This simple definition of the modern corporation identifies its two essential characteristics: it has a legal personality and it exists within a legal framework. The corporate personality and the legal framework have evolved over centuries, and have both statutory and nonstatutory elements to them.

The term corporate governance is not easy to define. Governance relates to a process of decision making and implementing the decisions in the interest of all stakeholders. It, furthermore, relates to enhancement of corporate performance and ensures proper accountability for management in the interest of all stakeholders. The Cadbury Report of 1991 on corporate governance considers it as "a system through which corporates are guided and directed." On the basis of this definition, the core objectives of corporate governance are distinct as under strategic focus, predictability, transparency, participation, accountability, efficiency and effectiveness, and stakeholder satisfaction. The strategy focus defines the direction the organization should take to meet its goals and to ensure stakeholder satisfaction. The strategic focus is based on predictability as the evolution of strategies to consider the dynamic environment within which it has to operate and hence the challenges from the environment need to be anticipated. A well-designed process to evolve and deploy strategy has to have transparency for all stakeholders so that there is a commitment and an understanding of the result expected from the operations. For proper execution of any processes aimed at achieving the desired result, participation of all stakeholders is important and actually necessary. The participation should have a clear goal of efficiency and effectiveness of the organization as a whole, and this is where accountability is the key. All stakeholders must have a clear understanding of their accountability for the most effective operations of any organization.

Theories of Corporate Governance

Corporate governance lacks little in accepted theoretical base or commonly accepted paradigm (Carver 2000; Tricker 2000; Parum 2005; Larcker, Richardson and Tuna 2004; Harris and Raviv 2008). Moreover, the forms of corporate governance are shaped nationally by economic, political, and legal backgrounds; by their sources of finance; and by the history and culture of the countries concerned.

With reference to a publication by the *Journal of Economic Literature*; *Corporate Governance: An International Review*, Hawley and Williams (1996) undertook a literature review of corporate governance in the United States as a background paper for "The Organization for Economic Cooperation and Development (OECD)." They identified four models of corporate control, which are as follows:

- the simple finance model;
- the stewardship model;
- the stakeholder model; and
- the political model.

While the *Survey of Corporate Governance* by Shleifer and Vishny (1997) for the National Bureau of Economic Research was not restricted to the United States, its scope was limited to the finance model consistent with the specialized definition of corporate governance adopted by the authors quoted earlier.

Both surveys contain some unstated culturally determined boundary conditions and assume that the U.S. context provides a universal reference. Shleifer and Vishny (1997) explicitly state that "while we pay some attention to cooperatives, we do not focus on a broad variety of non-capitalist ownership patterns, such as worker ownership and non-profit organizations." Nor are these types of firms considered by Hawley and Williams who do not state their boundary conditions.

In addition, Tricker (1996, 31) states:

> Stewardship theory, stakeholder theory and agency theory are all essentially ethnocentric. Although the underlying ideological paradigms are seldom articulated, the essential ideas are derived from Western thought, with its perceptions and expectations of the respective roles of individual, enterprise and the state and of the relationships between them.

In practice, corporate governance managers will have to adopt methods that are sensitive to country culture and practices to ensure effectiveness and relevance. They should avoid comparing company governance issues in developed world to emerging markets without looking at country-specific issues and context. This is particularly important for firms that are investing in emerging market economies.

Implicit assumptions of both surveys seem to be that all publicly traded firms have the following: rights of perpetual succession, limited liability, unitary boards and management hierarchies without related party transactions, strategic alliances or networks as found in non-Anglo firms, and unambiguous boundaries.

The Agency Model

This model in-line with neo-classical economics suggests that agents employed by distant owners or shareholders to act on their behalf are likely to be self-interested and opportunistic. Thus, agents serve their own interest rather than those of the principal owner. The theory further suggests to counter such problems, the principal will have to incur "agency cost"; costs that arise from the necessity of creating incentives that align the interest of the executives with those of the shareholders, and cost incurred by the necessity of monitoring executives' conduct to prevent the abuse of owner interest (Jensen and Meckling 1976). However, according to Eisenhardt (1989), agency theory specifies mechanisms that reduce agency cost such as schemes for managers (agents), which reward them financially for maximizing shareholders' interest. The roles of the chief executive officer (CEO) and board chairman should be spelled out such that the CEO should not be the chairman at the same time. The board should ensure that the role of the chairman is clearly consistent in achieving organizational objectives. The role should be well understood by all.

The Stewardship Model

Davis and Kay (1990) make a related set of observations contrary to the agency theory's pessimistic assumptions. According to them, the stewardship theory suggests the potential for what it calls the "pro-organizational" motives of directors and that what drives performance in this theory is not the aligned agreed of an executive but their personal identification with the aims and purpose of the organization. In addition, Davis, Schoorman, and Donaldson (1997) concluded that managers are more likely to serve organizational rather than personal goals when the needs are based on growth, achievement, and self-actualization; they identify themselves with their organization and remain highly committed to the organizational values; and their philosophy is based on involvement and trust in a culture-based collectivism and low power.

Stakeholder Theory

In defining "stakeholder theory," Clarkson (1995) states: "The firm" is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities. The purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services. Blair (1995, 322) who proposes supports to this view states: the goal of directors and management should be maximizing total wealth creation by the firm. The key to achieving this is to enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

In addition, the perspective of corporate governance on the stakeholder theory explains that, unlike "production view" in a firm, "managerial view" of the firm requires the top management to simultaneously satisfy the owners, the employees and their unions, suppliers, and customers in order to be successful (Freeman 1984). It would be significant to agree with Donaldson and Presten (1995) who indicated that the stakeholder theory is descriptive and instrumental. Thus, it may be a framework to test empirical claims, estimations relevant to stakeholder concept, and to examine the connections between corporate performance and stockholder management.

Political Model

The political model recognizes that the allocation of corporate power, privileges, and profits between owners, managers, and other stakeholders is determined by how governments favor their various constituencies.

According to Pound (1992), the perspective of corporate governance on the political model is to define the political approach where active shareholders exercise informal and ongoing form of management oversight through pooling their resources and power. He also found out that active and informed institutional investors use mechanisms like shareholder committee, director-nominating committee, and director-nominating petitions, issue campaigns, and friendly monitoring to exert informal pressure on the management of their target corporations.

Finance Model

The perspective of the financial model according to Shleifer and Vishny (1997) states that "in dealing with agency problems, the fundamental question that any corporate governance system has to answer is 'how to ensure suppliers of fund get a return on their financial investment.'" In addition, from the authors above, the theory results in significant legal protection of investor rights and controlled ownership through large shareholding, takeovers and bank finance, which can help investors, recoup their investments.

The theories discussed so far are largely on internal monitoring issues of corporate governance excluding the policy model. However, there are other theoretical approaches, such as the resource-dependence model, cultural perspectives, and institutional models that are focused on external governance mechanisms including external challenges and securing resources from the external environment.

Corporate Governance Role in Business Success

Corporate governance is considered a performance driver of the firm and much of the discussions of corporate governance focus on the assumption that the governance mechanisms influence performance (Aly and Simon 2008). However, there is no conclusive empirical evidence on how corporate governance mechanisms influence corporate performance. Most research examines the influence of specific aspects of corporate governance such as board of directors' remuneration policy, ownership structure, and capital structure on firm performance (Agrawal and Knoeber 1996, Demsetz and Villalonga 2001, Jackson and Moerke 2005, Thomsen et al. 2006).

In recent years, the topic of corporate governance has gained prominence because of the large number of attention-grabbing corporate scandals at the board level.

According to Sir David Tweedie, chairman of the International Accounting Standards Board:

> Executive boards failed, non-executives were kept in the dark, audit committees failed, auditors fell asleep at the wheel or let problems go, credit rating agents did none too well, analysts missed it, the SEC failed to regulate, and the investment banks and lawyers (and consultants) were part of the , problem helping companies with their questionable deals. It wasn't just one little piece gone wrong. The whole system was collapsing.

In a dissertation compiled by Oesch (2011), a previously unexplored dataset on international corporate governance attributes provided by Governance Metrics International (GMI) was used to investigate three distinct research questions. The first question: whether companies adopting better corporate governance were rewarded with higher firm valuations by capital markets? Results concluded, irrespective of estimation technique used, better firm-level corporate governance is associated with higher firm valuation.

The second question: whether a value relevance of firm-level corporate governance depends on the competitiveness of the industry a company operates? Using governance and competition measures superior to those used in previous U.S.-specific studies posited that better corporate governance leads to higher firm values only in concentrated industries. As to what concerns the channels through which governance increases firm value in noncompetitive industries, discovered evidence was that good governance for firms operating in noncompetitive industries leads them to have more capital expenditures and less expenditures on acquisitions. They are also less likely to engage in value-destroying diversification.

The third question: whether the corporate assets, especially cash holdings, are most susceptible to misuse by poorly governed managers. The main findings were that companies with relatively poor corporate governance hold more cash, and that the positive effect of cash holdings on firm value could be reduced for companies with relatively good corporate governance. However, agency problems, and therefore good corporate governance helping to overcome them, may affect firm value in two different ways. First, good corporate governance may lead to high stock price multiples as investors anticipate that less cash flows will be diverted and a higher fraction of the firm's profits will come back to them as interest or dividends (Jensen and Meckling 1976; La Porta et al. 2002). Second, good corporate governance may reduce the expected return on equity to the extent that it reduces shareholders' monitoring and auditing costs, leading to lower costs of capital (Shleifer and Vishny 1997). However, there is no unequivocal evidence to suggest that better corporate governance enhances firm performance in different market settings (Klein, Shapiro, and Young 2005). As a result, investors are still Skeptical about the existence of the link between good governance and performance indicators like share price performance and "for many practitioners and academics in the field of corporate governance, this remains their search for the Holy Grail—the search for the link between returns and governance" (Bradley, 2004, 9).

Importance of Corporate Governance

With reference to an article prepared by Vukčevićstates, Corporate governance creates the structure, in which the company objectives are defined, tools for their achievement and supervision by the owner over the operations of the company. If the corporate governance system is rigorous, it will give effective incentives to achieve the objectives in the best interest of the company and the shareholders. This will contribute to the more efficient supervision over operations, with direct impact on the effective use of resources in the company. Again, corporate governance contributes to growth and development of the corporation itself, the related activities and the state in general. The need for corporate governance arises because of the separation of management and ownership in the modern corporation. In practice, the interest of those who have effective control over a firm can differ from the interests of those who supply the firm with external finance.

> For a long time now, the role of the company is to not only produce or provide services and make profits in this way. Companies take responsibility for development of the social environment. It is not possible to ensure development of the company relying only upon the interest of the company, while neglecting the overall development of the community. Corporate governance contributes to improved efficiency and effectiveness of the economic system. The existence of an efficient system of corporate governance within a company or the economy as a whole helps to reach the level of trust necessary for proper operations of a market economy.

The Commonwealth Association for Corporate Governance, in its publication "CACG Guidelines—Principles for Corporate Governance in the Commonwealth," states: "The globalization of the market place within this context has ushered in an era where the traditional dimensions of corporate governance defined within local laws, regulations and national priorities are becoming increasingly challenged by circumstances and events having an International Impact." This underscores the importance of Ghana and Africa for that matter building institutions that will ensure that principles of good corporate governance are adhered to make Africa an attractive destination for international investment.

Challenges in Corporate Governance in Africa

In Nigeria, according to Okpara (2011), Effective corporate governance is significant for firms in developing countries because it can lead to managerial excellence and help firms with a weak corporate governance structure to raise capital and attract foreign investors. However, a number of constraints hinder the implementation and promotion of corporate governance. These constraints include weak or nonexistent law enforcement mechanisms, abuse of shareholders' rights, lack of commitment on the part of boards of directors, lack of adherence to the regulatory framework, weak enforcement and monitoring systems, and lack of transparency and disclosure.

In a research survey by Edmans (2013), he reviewed the theoretical and empirical literature on the different channels through which block holders (large shareholders) engage in corporate governance. In classical models, block holders exert governance through direct intervention in a firm's operations, otherwise known as "voice." These theories have motivated empirical research on the determinants and consequences of activism. Models that are more recent show that block holders can govern through the alternative mechanism of "exit"—selling their shares if the manager underperforms. These theories give rise to new empirical studies on the two-way relationship between block holders and financial markets, linking corporate finance with asset pricing. Block holders may also worsen governance by extracting private benefits of control or pursuing objectives other than firm value maximization.

Empirical Evidence of Corporate Governance Success

Some recent studies provide empirical support for corporate governance in business success. Giroud and Mueller (2011 GM) "found the strength of the relation between long-term stock returns, firm value, as well as operating performance and corporate governance to decrease monotonically in the degree of product market competition."

Murphy (1985) finds that executive compensation is strongly positive in relation to corporate performance, suggesting "ownership structure can represent an endogenous outcome of the compensation contracting process" (Cho 1998, 106). The efficiency of alternative governance structures depends upon the environment within which they operate. Fan (2004) claims that existing theories of corporate governance have not been successful in recognizing the determinants of good corporate governance as it operates in highly complex diverse environments. The findings of Abor and Fiador (2013) clearly suggest that, with respect to South Africa, Kenya, and Ghana, good corporate governance structures lead to high-dividend payout, probably due to easy access to and low cost of external finance.

In a work compiled by Munisi and Randøy (2013), they examined the extent to which publicly listed companies across sub-Saharan African countries have adopted "good corporate governance" practices.

An investigation conducted with association of the practices of companies' accounting performance and market valuation indicated that companies across sub-Saharan Africa have only partly implemented good corporate governance practices. Knyazeva (2007) in his research found that in the absence of strong corporate governance, dividends can limit inefficient managerial investment. His results showed that weak governance has a positive effect on dividend changes, mainly in response to large cash-flow increases, and also total payout adjustments made by weakly governed managers support the dividend commitment. Adjaoud and Ben-Amar (2010) investigated the relationship between corporate governance quality and dividend policy in Canada. Using a sample of 714 firm-years listed on the Toronto Stock Exchange over the period 2002–2005, they found that firms with stronger corporate governance have higher dividend payouts. Their results indicate that board composition and shareholder rights' policy are positively related to payout ratios. Good Corporate Governance can be summarized into five basic tenets:

- accountability,
- efficiency and effectiveness,
- integrity and Fairness,
- responsibility, and
- transparency.

Corporate Governance in Africa

- The Africa Capital Markets Forum is undertaking a study on the state of corporate governance in Africa.
- The King's Committee Report and Code of Practice for Corporate Governance in South Africa published in 1994 continue to stimulate corporate governance in Africa.
- Zimbabwe, Ghana, Uganda, and South Africa have put in place national institutional mechanisms to promote good corporate governance.
- Communities and countries differ in their culture, regulation, law, and generally the way business is done. In consequence, as the World Bank has pointed out, there can be no single

generally applicable corporate governance model. Yet there are international standards that no country can escape in the era of the global investor. Thus, international guidelines have been developed by the Organization for Economic Cooperation and Development (OECD), the International Corporate Governance Network, and the Commonwealth Association for Corporate Governance. The four primary pillars of fairness, accountability, responsibility, and transparency are fundamental to all these international guidelines of corporate governance. This applies to Africa as well.

- Training, technical, and awareness raising support has been extended by the World Bank and the Commonwealth Secretariat to various African countries such as Botswana, Senegal, Tunisia, Mali, Mauritania, Cameroon, Gambia, Mozambique, Mauritius, Sierra Leone, and Zambia to help them put in place appropriate mechanisms to promote good corporate governance.
- Here level of integrity and fairness, accountability, transparency, effectiveness, and efficiency in corporate governance will all be influenced by various factors such as culture, rule of law, political controls, and level of democracy.

Limitations of Corporate Governance

Corporate governance lacks any agreed theoretical base or commonly accepted paradigms (Carver 2000; Tricker2000; Parum 2005; Larcker, Richardson, and Tuna 2007; Harris and Raviv 2008). Pettigrew (1992), Tricker (2000), and Parum (2005) argue that corporate governance research lacks coherence of any form, either empirically, methodologically, or theoretically, meaning that only piecemeal attempts have been made to understand and explain how the complex modern organization is run. As a result, researchers in explaining and analyzing corporate governance in economics, finance, management, and sociology have used a number of different theoretical frameworks originating from a broad range of disciplines. Using various terminologies, these frameworks view corporate governance from different perspectives.

Table listing the key types of theoretical framework and their limitations

Theoretical framework	Basic discipline	Limitations
Agency	Economics	With the lines between agent(s) and principal(s) getting blurred the governance model based on the agency theory runs into severe limitations.
Stakeholder	Management	It fails in determining the difference between means and ends—when everything (objectives of all stakeholders) is a goal, then nothing is a goal.
Stewardship	Psychology and sociology	Directors see their roles as being stewards of particular groups only.
Political	Governance	Places severe limitations on the traditional economic analysis of the corporate governance problem, and locates the performance-governance issue squarely in a broader political context.

Source: Author's review of literature.

Stiles and Taylor (2001) argue that fragmentation of these various perspectives has led to a lack of consensus regarding corporate governance and the actual role of the board of directors in the organization as the nature of board's contribution (and the expectations placed upon it) depends heavily on which theoretical perspective used.

In addition, the issue of "endogeneity" often creates a problem while conducting research on corporate governance. In the past, researchers did not consider this issue with reasonable care. For example, studies like Morck et al. (1988) and McConnell and Servaes (1990) have not addressed the endogeneity problem as they treated ownership structure as exogenous in explaining the relationship between ownership structure and corporate value. Hermalin and Weisbach (1991) and Wintoki and Tang (2007) argue that current actions of a firm affect future corporate governance as well as performance, which will in turn affect the firms' future actions.

The Future of Corporate Governance

Corporate governance has gained an increasingly high profile in the last two decades. The recent global finance crisis has further focused attention on how corporate governance might be improved and helps restore confidence in stock markets and firm's generally. Effective and efficient management of public sector organizations is an issue of concern in many countries. Melese et al. (2004) argue "public sector organizations are increasingly being held more accountable for their performance and are therefore expected to operate efficiently and effectively." This means that public sector organizations have to search for ways to improve activities. Notable approaches include the use of performance contracts. Similarly, activity-based management practices can increase transparency and efficiency when conducting government activities, thereby assisting public sector organizations to achieve their objectives (Baird 2007; Melese et al. 2004).

A number of developing countries have embraced the corporate governance ideals. However, developing countries practice corporate governance models that are different from the models adopted by developed countries (Rabelo and Vasconcelos 2002). Given that emerging market firms may raise certain kinds of governance concerns in a more prominent manner than developed market firms (e.g., controlled verses dispersedly held firms governance concerns), and that the background institutional structures are less consistent across emerging markets, one might expect that the behavior and optimal governance of emerging market funds could be different than the behavior of similar investors in more developed markets (Khanna and Zola 2010). In an article written by the Institutes of Director's Southern Africa states, "African economic growth will not be sustainable if the continent does not improve its reputation for corporate governance, says Ansie Ramalho, CEO of the Institute of Directors in Southern Africa (IoDSA). Ramalho was speaking ahead of the second meeting of the African Governance Network, to be held in Harare on 10 and 11 June 2013." Further statement made that "Africa's growth will be real only if it develops strong companies able to compete successfully in their home and overseas markets" says Ramalho. "We know from the experience of the developed world that governance is essential to sustained corporate success." This is especially important in the context of emerging markets where many of the institutions protecting investors in more developed markets may not be fully present (Khanna and Zyla, 2010). Institutions from South Africa, Mauritius, Nigeria, Zimbabwe, Kenya, Tanzania, Malawi, Mozambique, and Zambia are all members of the new governance network. The New Partnership for

Africa's Development (NEPAD) Business Foundation and ACCA are two of the partners who collaborate on this initiative. Jamil Ampomah, director—sub-Saharan Africa for Association of Certified and Chartered Accountants(ACCA), said that ACCA is an active participant in global developments in corporate governance and risk management. Also stressed, "Good corporate governance is one of the key elements that will support the growth, and shape the future, of Africa."

The Principles of Responsible Management Education

An international task force of 60 deans, university presidents, and official representatives of leading business schools and academic institutions developed this UN initiative in 2007. Inspired by internationally accepted values, such as the principles of the United Nations Global Compact, principles of responsible management education (PRME) seeks to establish a process of continuous improvement among institutions of management education in order to develop a new generation of business leaders. Launched at the 2007 UN Global Compact Leaders Summit in the presence of UN Secretary General Ban Ki-moon, the mission of the PRME is to inspire and champion responsible management education, research, and thought leadership globally. The six principles identified are as follows:

Purpose: We will develop the capabilities of students to be future generators of sustainable value for business and society at large and to work for an inclusive and sustainable global economy.

Values: We will incorporate into our academic activities and curricula the values of global social responsibility as portrayed in international initiatives such as the United Nations Global Compact.

Method: We will create educational frameworks, materials, processes, and environments that enable effective learning experiences for responsible leadership.

Research: We will engage in conceptual and empirical research that advances our understanding about the role, dynamics, and impact of corporations in the creation of sustainable social, environmental, and economic value.

Partnership: We will interact with managers of business corporations to extend our knowledge of their challenges in meeting social and environmental responsibilities and to explore jointly effective approaches to meeting these challenges.

Dialog: We will facilitate and support dialog and debate among educators, students, business, government, consumers, media, civil society organizations, and other interested groups and stakeholders on critical issues related to global social responsibility and sustainability.

Comments on the six principles: Business schools in Africa should strongly adopt these six principles. Academicians on the African continent should research along these principles to encourage the inculcation of good governance principles at early stages of youth development.

Methodology

In assessing corporate governance in Ghana, the research method used was mainly qualitative. Focused group discussions were used as the method of data collection. In a few instances, personal observations were also made. The focus here was on the opinions of MBA students who mostly worked within the first hundred (100) companies in Ghana.

There were six focus groups with an average of 10 participants per group. Each group consisted of a moderator, a scribe, and its members.

The aim of the focus group discussion was to find out how these graduate workers understand corporate governance issues in Ghana.

The following questions were asked:

1. How do we ensure good governance?
2. Does the legal framework and environment in Ghana encourage good corporate governance?
3. Do you consider political influence a major issue of governance for public organizations?
4. Does good governance give confidence to investors?
5. Does governance mechanism—company size, board number, ownership structure, and the number of years of operations, influence performance?

6. Do foreign companies have a better grasp on governance issues than local companies?
7. Are foreign companies more strategic than local companies?
8. Do foreign firms demonstrate a better grasp of the various dimensions of corporate governance better than local firms?

Analysis, Findings, and Discussion

1. How do we ensure good governance?
   In answer to this question, three of the six groups (50 percent) believed that in order to ensure good governance, the organization's vision and mission must be clearly defined, understood, and adhered to by all. The three groups' response was unanimous. They believed that the organization's structure must be well formed with a good organogram linked with company ethics and culture, and that there should be an effective communication within the organization with the appropriate channels. The other three of the focus group were of the opinion that to ensure good governance, there was the need for the members of the board to be from diverse backgrounds without control and power exhibited by one or a few, thus basically ensuring a fair representation of all expertise or professions. They were of the opinion that there should be a monitoring team and regulatory body that will ensure that they are accountable for what they do and also ensure that decisions taken are adhered to. Moreover, it is essential that there is a follow-on monitoring and evaluation of systems and processes.
2. Does the legal framework and environment in Ghana encourage good corporate governance?
   Five out of the six focus groups (83.3 percent) were of the opinion that the legal framework and the environment in the country were good enough to encourage good governance. They believed that the interplay between internal incentives and external forces including policies, legal structures, regulations, and the market forces in the country provided a fertile ground for the practice of good governance. The remaining group (16.7 percent) disagreed, stating that the culture of corruption and pursuit of easy access to wealth and the

naivety of shareholders did not encourage good governance in the country. They were of the opinion that laws were not being enforced to ensure good governance in the country. Hence, organizations in emerging markets like Ghana must ensure that procedures and processes are in place to facilitate the implementation those laws.

3. Do you consider political influence a major issue of governance for public organizations?
   In answer to this question, all the members of the six focus groups (100 percent) were of the opinion that political influence was really a major issue of governance for public organizations due to the fact that the political party in power directly or indirectly has great influence in the appointment of people to very sensitive positions in public organizations, hence influencing decision making within the organization. They were of the opinion that as different political parties comes into power they seek to control the public organizations to achieve their own political goals.
4. Does good governance give confidence to investors?
   All the six focus groups (100 percent) agreed that good governance gives confidence to investors. This outcome is not surprising since most respondents are followers of investment news both globally and in Ghana. Members believed that good governance gave investors a sense of security and trust in the safety of their investment, knowing it was going to be well managed by that organization. They based their decision on the fact that good governance brings about predictability, accountability, transparency, and participation, which creates an investment-friendly environment to attract investors.
5. Does governance mechanism—company size, board number, ownership structure, and the number of years of operations, influence performance?
   Four out of the six groups (66 percent) were positive that it did. They believed among other things that the number of people on the board could influence decision making and hence performance. The number of years in operation was cited as very important as it brings along with much need experience. They said company size could also make it easier to acquire the quality manpower needed for good

performance. One group (18.5 percent) was, however, of the opinion that governance mechanism did not exactly have influence on performance. They were of the opinion that number of years in operation did not necessarily translate into quality knowledge needed for performance. They believed that political interference made no sense the effectiveness of board members, and that ownership structure had little to do with performance as it is the board that controls decision making. A last group was indecisive on the matter.

6. Do foreign companies have a better grasp on governance issues than local companies?
   Most of the respondents thought that "yes" foreign companies have a better grasp on governance issues than local ones because of the less interference.
7. Are foreign companies more strategic and ethical than local companies?
   Most of the respondent indicated that foreign companies are more strategic and ethical than their local counterparts.
8. Do foreign firms demonstrate a better grasp of the various dimensions of corporate governance than local firms?
   Four out of the six groups (66 percent) were positive that it did. They believed that foreign companies performed better partly due to better understanding of governance issues.

Conclusion and Future Outlook

On October 24, 1999, the Global Corporate Governance Forum Secretariat published the 2nd Edition of "The Inventory—A survey of Worldwide Corporate Governance Activity" in which it notes on page 36: "At a global level, the survey responses indicate that . . . companies in these emerging markets, traditionally unwilling to pay for corporate governance-related services, now understand the importance of changing their Board and disclosure practices in order to better attract international sources of capital. . .".

It is worth noting that James D. Wolfensohn, president of the World Bank, states:

"The proper governance of companies will become as crucial to the world economy as the proper governance of countries."

By meeting their corporate governance demands, companies and countries as a whole can demonstrate how they are well managed, identify threats to their corporate survival, and provide stakeholders with confidence that the organization's strategic objectives will be achieved. "The adoption of corporate governance principles by African countries will be a major step towards creating safeguards against corruption and mismanagement, promoting transparency in economic life and attracting more domestic and foreign investment" (Okeahalam, 2004).

Corporate governance in Ghana and Africa can be improved by establishing effective programs to counter corruption and bribery. It has been established from this research that good corporate governance can lead to better organizational performance. Good leadership leads to higher trust in management. Better governance gives higher investor confidence. The future belongs to nations, organizations, and individuals who respect and implement good governance.

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Discussion Questions

1. You have just been appointed as company secretary of a medium-sized listed company. In discussions with your chairman, you discover that he has serious concerns about the quality of decision making by the board of directors. He believes that decisions by the board are often taken on the basis of insufficient information and without due regard for either risk or the environmental, social, and governance (ESG) issues involved. He mentioned that a recent example of poor decision making had been a decision by the board to invest a large amount of money in developing a major new product, only to discover later that there were serious concerns about the environmental impact of the product and a very high probability that the product would be banned by the government's Product Standards Agency. The board had therefore canceled the product development project, with a large write-off of the expenditure already incurred. This was just an example of badly informed decision making by the board and the chairman says that there have been others. He wants to improve the work of the board, but is unsure about what needs to be done, and he has asked for your views and advice in the form of a report.

Required

Write a report to the chairman, advising him on the measures that might be taken to improve the quality of decision making by the board. In the report, you should take into consideration the concerns that he has expressed and the recent example of poor decision making that he mentioned.

2. For some years Lee Tomm ("Lee") was the assistant company secretary of a large listed company, but he has now decided to take up the offer of employment at a senior advisory level with a government organization. This organization, the Consumer Protection Board (CPB), has responsibility for monitoring and controlling monopolies and mergers in industry and for protecting the consumer against anticompetitive practices.

Lee is aware that the CPB has been criticized in the media for poor governance. It does not engage much with its stakeholders, such as the government department, that provide its funding and consumer protection groups. In his time as assistant company secretary of the listed company, Lee was involved in a variety of corporate governance matters, and he is aware of the importance of good governance. He considers this to be important for nonprofit-making organizations as well as for companies, although he understands that governance priorities in the CPB should differ in some respects from those in listed companies.

Required

a. Discuss the main differences between corporate governance in a major stock market company and governance in a state-owned organization such as the CPB.
b. Suggest how the skills and experience gained by Lee with the listed company can be transferred and applied to his new role with the CPB.

3. Write an essay on corporate governance in your country.
4. Discuss the nature and purpose of corporate governance.
5. Discuss the characteristics of corporate governance.
6. Discuss the link between corporate governance and business success.
7. Explain the role of directors in corporate bodies.
8. Define corporate governance and list its scope.
9. Who is a director? How are directors appointed in a company?
10. Briefly explain the structure of corporate governance in your country.

CHAPTER 11

Corporate Governance and Microfinance in Ghana: A Qualitative Insight of Key Stakeholders

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Abstract

Microfinance institutions (MFIs) are recognized around the globe as a key agent of development especially in the life of low-income people who earn below $2 a day who are described as nonbankable because they are not attractive to commercial banks. However, the behavior of some MFIs calls for a deliberate investigation into corporate governance (CG) with respect to MFIs in Ghana. Using a qualitative research approach supported by thematic research and deductive analysis, the researcher interviewed key informant stakeholders to evaluate the extent to which MFIs in Ghana have embraced good CG to grow their businesses and to identify challenges associated with governance behavior of

MFIs. It was discovered from the study that most MFIs in Ghana have contributed immensely toward the growth of Ghana's financial service delivery especially in the informal sector. The study further revealed that MFIs need to operate under stringent CG policies enforceable by regulators. The managerial implications are that MFIs operating in developing countries including Ghana ought to appoint experienced professionals with backgrounds in sales and marketing, finance and risk management, human resource, entrepreneurship, and law to empower them to champion the true cause of microfinance operations to benefit low-income customers, employees, and investors. In addition, qualified and experience women should be considered as board executives. Considering the inherent limitations of the study on qualitative approach, other research methods such as the quantitative or mixed research could be considered for future studies.

Keywords: microfinance, corporate governance, nonbankable, stakeholders, Ghana.

Introduction/Background

Maximizing shareholders' wealth is an essential corporate goal that cannot be ignored by business managers operating in both the public and private sectors. The quest for integrity in business not only is aimed at ameliorating malfeasance in business with its associated risks but also calls for changes in life with new demands in global business especially regarding the recent economic crisis that could be avoided (Stachowicz-Stanusch and Amann 2012).

Good CG practice and sound financial management contribute to maximization of shareholder value, which ultimately help in serving customers who are the reason behind corporate existence (Gill and Obradovich 2012). History has it that CG scandals such as Enron, World Com, and Commerce Bank that are attributable to poor CG have reduced investors' faith in capital markets and the efficacy of existing CG practices in promoting transparency and accountability among organizations (Connelly and Limpaphayom 2004; Gill and Mathur 2011; Gill and Obradovich 2012; Htay 2012; Htay et al. 2013; Ponnu and Ramthandin 2008). Again, weakening the faith of investors has had a negative effect on share values, consequently on the overall value of firms.

Nevertheless, good CG is seen as a system that delineates the rights and responsibilities of major internal stakeholders of organizations, thereby helping to spell out clearly regulations, policies, and procedures for making sound decisions regarding corporate affairs (Organization for Economic Co-operation and Development [OECD] 2004). In addition, good CG systems and structures help institutions to direct and control governance structures, solely to enhance wealth creation capacity and growth of organizations (Needles et al. 2012).

Throughout history, especially during the Middle Ages (around AD 600–1500) where the quest for knowledge and human development was low compared to today, researchers developed appropriate CG models based on their predicament through practice and periodic analysis of CG issues to confront challenges faced by organizations. Of course, values underpinning what is considered as good governance might not be considered appropriate today due to changes over time.

Strategically, CG essentially helps in shaping and directing the affairs of organizations to ultimately achieve stated corporate goals. It must be emphasized that good CG practice affects the socioeconomic life of customers, employees, shareholders, and the entire community.

Governance is a process by which the boards of directors of organizations work via management teams through guidance and prudent controls to fulfill corporate missions and goals, and to protect the entity's assets for shareholders. CG, in the real context of academia, can be defined as a set of processes, systems, structures, customs, policies laws, and institutions that influence the way a firm directs, controls, and operators with the support of management and the board of directors of companies (Rouf 2011).

The fundamental of good governance is the ability of individual directors of the companies to work in partnership with stakeholders especially management to balance both strategic and operational responsibilities to achieve the stated goals of the organizations. Normally, effective CG occurs when the board of directors provides proper guidance to management on strategic direction of companies and oversees management's operations in a positive light (Rock et al. 1998). The relationship between corporate boards and management must be cordial and anchored around strategy, teamwork, and sound implementable policies.

Available records reveal that governance of microfinance institutions (GMFIs) first appeared in 1997 and show a strong correlation between boards of directors and management performance of MFIs (Lapenu and Pierret 2006). Furthermore, literature highlights the relevance of GMFIs as an essential driver for enhancing the viability of the sector since they compete with commercial banks that are more capitalized, operating under strong regulated regime, CG policy supported by positive public image compared to MFIs (Mersland and Strøm 2009; Mersland 2011; Varottil 2012).

Evidence further shows that successful regulatory options available to MFIs include self-regulation, peer regulation, and other special regulatory principles serving as specific performance indicators or rules and guidelines. However, these general principles and guidelines on CG practice are yet to be put into practice by most MFIs operating in the developing world (Arthur, Garvey, et al. 1993; Mersland, 2009; Thrikawala et al. 2013). The absence of these could be attributed to cultural and regional norms specifically tailored solely for MFIs (Gant et al. 2002). Varottil (2012) concurs that MFIs need a specific CG framework based on empirical research outcomes since their operation is unique compared to commercial banks.

Microfinance is the supply of banking services to micro and small enterprises, and low-income individuals including micro-funds mobilization and disbursement, micro insurance, and funds transfer (Rahman 2007). MFIs play a dual role by reaching out to low-income, unbanked clients, thereby making them financially sustainable and simultaneously contributing to poverty reduction in the long term to achieve the millennium development goals (MDGs) prescribed by the United Nations (2000). This means that MFIs must focus on building sound financial marketing strategies that meet the diverse financial needs of underserved people (Armendáriz de Aghion and Morduch 2004). Furthermore, microfinance is all about alleviating poverty in the medium and long term, especially in developing countries (Brau, Hiatt, and Woodworth 2009; Hermes and Lensink 2011; Daley-Harris 2006; Thrikawala 2013). Again, MFIs contribute positively to improving market infrastructure, increase product choice for consumers and empower low-income customers to access quality health care and education. These ultimately improve the standard of living of the unbanked poor to afford quality but low priced goods and services.

The poor, usually individuals, are considered "nonbankable" and not credit worthy due to lack of physical assets; therefore, granting them credit may seem "very risky" to the financing public. Nevertheless, Grameen bank's model developed by Mohammed Yunus in 1999 won the Nobel Peace Prize. This could be attributed to the successful adoption and implementation of pro-poor marketing strategies to extend finance to low unbanked clients classified as "bottom of the pyramid clients" to achieve marketing and corporate goals (Hassan et al. 2013; Mersland and Storm 2007).

Today, microfinance activities are being projected high at national, international, and global stage, attracting the attention of the United Nations that to the Year of Microcredit in 2005. Christen et al. (2004) also observe that an overwhelming 500 million individual bank customers hold savings accounts worldwide. In 2006, the Microcredit Summit was held at Halifax, Canada, to celebrate the milestone of 100 million borrowers, which gives extra credence to the feasibility of the microfinance phenomenon even in the developed world. Despite the aforementioned developments, microfinance is only available to a fraction of the world's nonbankable population living mostly in developing countries (Christen et al. 2004; Robinson 2001), denying many millions of poor people financial services. The aforementioned challenge could be associated with the perceived associated risk (C-GAP 2004, 2006; Helms 2006), a concern for all genuine microfinance stakeholders in the developing world.

Stakeholder theory as a management theory was developed by Freeman (1984), extending the responsibility of top corporate players from shareholders to other stakeholders like directors, managers, and customers to work together for corporate success. This theory is anchored around philosophical ideas from economics, ethics, law, and management. Stakeholders are groups or individuals who can affect or are affected by the achievement of a company's existence purpose (Freeman 1984; Freeman 1994). Freeman in 1984 based his theory by asking critical questions on stakeholder benefit, expense, and company management; however, rhetorically, these questions seek answers from the broader stakeholder groups, touching on benefits to corporate growth and development.

These stakeholders work through relationships for their mutual benefit. Nevertheless, academic findings reveal that it is quite vague to understand who qualifies and who benefits most from such business relationship since the benefit could be mutual (Orts and Strudler Agatiella 2002).

The term "triple bottom line" was allegedly coined by Elkington (1997; Sarre and Treuren (2001), but was not popularized until there was widespread publication of 1997 book. The *Triple Bottom Line of 21st Century Business* book focuses on a firm's strategy and not just on the economic value, but a firm's ability to support both environmental and social values of the community. The term "triple bottom line" is used as a framework for measuring and reporting corporate performance against economic, social, and environmental parameters (Vanclay 1999). Furthermore, the term was used to capture the whole set of values, issues, and processes that companies must address in order to minimize any harm resulting from activities to create economic, social, and environmental value. This involves being clear on a company's purpose and taking into consideration the needs of all stakeholders, namely, shareholders, customers, employees, business partners, governments, local communities, and the public that applies strongly to MFI managers (SustainAbility 2003) whose responsibility among others regarding this study, is to satisfy low-income clients.

Broadly speaking, stakeholders of an entity comprise of employees, creditors, suppliers, customers, competitors, the local community, and the general public (Ayuso et al. 2007). This theory extends the responsibility of the directors of organizations toward good corporate social responsibility (CSR; Amaeshi 2010), which focuses attention on corporate morality on profit maximization (Htay et al. 2013). This means that microfinance activities are of much concern to all stakeholders including customers, managers, industry advocates, and researchers from academia.

Social responsibilities of the "businessman" was first featured in 1953 and later changed to CSR (Valor 2005); was earlier indicated by Davis (1960) that CSR is a business decision and actions must be taken for reasons partly because of the firm's direct economic or technical interest. Normally, a company's objectives ought to be in line with society's value and well-being (Bowen 1953; McGuire 1963); hence, true social responsibility supposes that organizations must think not only of economic well-being but also legal obligations that must be voluntary. These responsibilities quietly describe the corporate behavior that prevails on organizations to meet social norms, values, and expectations (Sethi 1975).

Carroll (1979) notes that CSR goes beyond the law, arguing that CSR, if fully imbibed by organizations, will address a wide range of obligations that firms owe toward society, which comprise economic, legal, and ethical elements. In support, other researchers (Aupperle et al. 1985; Burton and Goldsby 2009; Clarkson 1995; Wood 1991) observe that CEOs should see their social responsibility in four main categories, namely, profitable behavior, obeying corporate and social laws, ethical behavior, and giving generously to society through philanthropy. This can broadly be summarized into profit (economic), law abiding (legal), being ethical (ethics), and being a good corporate citizen (Hemphill 2004). The question to be asked is does MFIs in developing countries consider these factors as part of their broader strategy to achieve their goals?

Ghanaian Context Overview

Ghana, located along the west coast of Africa, was classified as a lower middle-income country in 2010 after rebasing its economy to reflect its new status in economic growth. Economies of countries are rebased to replace the old base year by compiling constant price estimates to a new and more recent base year. In real terms, Ghana's GDP estimate as at 2010 stood at GH¢24.187 billion up from GH¢22.454 billion representing 7.7 growth in 2009 (GSS 2010). The country achieved sustained political stability for over three decades, with remarkable development in most sectors of the economy especially in financial services delivery over the past decade. However, 80 percent of the Ghanaian workforce is employed in the informal sector (Osei-Boateng and Ampratwum, 2011). The informal sector is made up of proprietary of micro and small-scaled enterprises.

In the 1990s, the Government of Ghana enacted the financial sector adjustment program (FINSAP) as an essential financial reform policy for restructuring and enhancing the country's legal and regulatory framework. The FINSAP reform aimed at managing the country's financial sector through liberalization of interest and exchange rates, which hitherto was regulated by the state instead of market forces. Financial services such as banking, savings and investment, insurance, and debt and equity financing help citizens to save against future uncertainties since prudent financial management helps to reduce financial risk. Again, availability of credit to small- and medium-scale enterprises (SMEs) helps to expand and increase efficiency of SMEs to compete effectively in both local and international markets and to create jobs for the youth.

According to Sowa (2003), Ghana experienced a critical financial crisis in the mid-1980s, which resulted in high inflation and unemployment, scare foreign exchange, and low international trade among other poor economic indicators. For the poor, who earn below $2 per day (United Nations 2006), the lack of financial services, and a chaotic, crisis-ridden banking system make them vulnerable. The poor are cut off by formal financial service providers such as commercial banks that require collateral in order to qualify for credit. Therefore, availability of microfinance enables the poor to manage available assets in ways that generate income that ultimately creates paths for the poor unbanked clients that MFIs serve to reduce poverty (World Bank 2001).

Microfinance operations in Ghana have in recent years become an attractive financial service alternative, attracting different players into formal and informal sectors. The Central Bank of Ghana, the main regulator of the sector, categorized community rural banks, saving and loans companies, credit unions, financial nongovernmental organizations (FNGOs), microfinance companies as well as Susu collectors and money lenders as key actors of microfinance business (BG/GOV/SEC/2011). Susu is a daily self-micro savings made by individuals in Ghana's SME sector, which has been a savings culture for people in the informal sector for ages. Ghana Susu Collectors Cooperatives members go around daily from individual to individual and SMEs to collect micro savings. These cooperatives receive one-thirtieth of every monthly collection as reward. They mainly serve the informal market with financial services such as micro savings, microloans, and micro insurance products.

Governance Challenges in Ghana's MFI Market

In the microfinance sector, discussion on microfinance governance has reached a crescendo for several reasons. First, MFIs grow through outreach, size of assets, and portfolio. Secondly, effective management growth requires added input and involvement by a board of directors who are normally deemed to have more experience than management teams on the ground. Additionally, increasing number of MFIs raises regulation concerns for stakeholders because of related operational challenges. For example, capturing deposits from customers and investors of MFIs is perhaps one of the most important challenges requiring the greatest oversight responsibility in the form of quality CG intervention. Finally, MFIs are operating in increasingly competitive markets therefore, making it difficult for sustaining and increasing market share, which is crucial for shareholders.

Governance is about establishing clear business, function strategies, and policies to achieve corporate goals. This will result in customer and employee satisfaction, profits for shareholders, and be ahead of competition. Good CG is also essential for improving corporate value that differs from country to country because of disparity in CG structures, resulting from dissimilar social, economic, and regulatory conditions (Rouf 2011). However, despite the perceived differences, good CG aims at ensuring that managers of organizations operate within state-guided rules, framework, and agreed norms of the organizations. Good CG has been adjudged by scholars as a means of strengthening financial performance and outreach growth of firms (Helms 2006; Labie 2001; Mersland and Strom 2007; Rock et al. 1998; United Nations 2006).

Activities of MFIs in Ghana are clearly visible across most communities especially at market centers where commercial activities take place. To win the market, these MFIs employ management and innovative marketing strategies to woo the unbanked poor clients with prompt services delivery, although they are highly priced. Anecdotal evidence suggests that MFIs in Ghana over price their loans far above commercial banks. Annual interest rates of the sector range between 36 and 120 percent, far above that of commercial bank rates that range between 24 and 36 percent (Dzogbenuku 2014). However, recently operations of some MFIs of Ghana have come under serious public scrutiny as they are perceives not to be fully championing the true interest of low-income unbanked clients.

In addition, over the past few months, the country has witness persistent collapse of major MFIs in both cities and rural communities, casting serious doubt about their operational integrity, loyalty to clients, and CG credibility, which are critical for financial service delivery. These and many other unfortunate situations have caused fear and panic among customers and investors. The financial public is now crying for the Central Bank, the main regulator, to crack the whip by strengthening its monitoring and regulatory functions to weed out charlatans in the sector.

Furthermore, the public is also calling for up-ward revision of the sector's minimum capital requirement for MFIs aimed at discouraging new entrants. Also, recommended by pundits is the blacklisting of unscrupulous microfinance operators. These unfortunate developments continuously agitate the minds of the financial public, calling for prudent proactive regulatory CG structures supported by policies to benefit all stakeholders, especially poor customers and investors.

This study seeks to evaluate whether MFIs in Ghana have sufficient robust CG structures in place to guide operations of MFIs and to identify challenges confronting the sector regarding prudent CG functions. In contemporary times, good CG has become more important since it demands transparency and accountability of investors and donors. Furthermore, operations of MFIs require solid governance framework to minimize the possibility of mismanagement of investors and customers funds.

The strength of good CG practice by organizations leads to improved financial performance (Chung, Wright, and Kedia 2003; Hossain, Cahan, and Adams 2000), and strengthens board–management relationships to achieve objectives, thereby promoting growth and development (CSFI 2008; Cull, DemigÄuc-Kunt, and Morduch 2007; Hartarska 2005). Further, CG will improve financial performance and increase outreach, survival, and customer satisfaction of poor unbanked customers of MFIs (Aboagye and Otieku 2010; Kyereboah-Coleman 2007; Kyereboah-Coleman and Osei 2008; Thrikawala 2013).

From the management perspective, the business of a firm is to be managed under the direction of a board of directors and management, while employees become responsible for the day-to-day administration of the affairs of the firm (Kojoka, 2008). Directors of organizations, commonly known as the board of directors, ought to have rich experience across most sectors and thus are expected to contribute quality leadership and direct the affairs of businesses with a high level of integrity and commitment to the firm's strategic plan and long-term shareholder value (Gill and Obradovich 2012).

In general, most MFIs because of their background have more than one corporate goal which are poverty alleviation and stakeholder value. This is achieved by reaching out to the poorer population through outreach (Helms 2006; Johnson et al. 2006) and achieving financial sustainability in the long term.

The agency cost model developed by Labie (2001) could be applied to the MFI sector and linked to MFI outreach performance instead of financial performance. The priority for MFIs compared to traditional firms is to assess CG capability of MFIs. Again, in the microfinance sector, CG issues are subjected to a different set of factors that successfully measure the relationship between financial performance and outreach to meet the aspiration of both shareholders and customers. Operations of MFIs demonstrates some relationship between organizational performance and CG using secondary data of third-party rating agencies to suggest that there is some correlation between MFI performance and governance.

Varottil (2012) and Sinclair (2012) opine that commercialization of MFIs from nonprofit institutions to for-profit institutions has created several issues in the industry. Commercialization of MFIs has assisted in scalability and outreach by broadening the scope of financial support for poor people, and forced MFIs to turn back their social goals. According to Arena (2012), at present microfinance providers seem to be drifting away from their mission and sound CG practice. This is because existing CG practices of MFIs fuel only the perception that private interests are far above the vulnerable poor.

In all, it ought to be emphasized that MFIs must be managed with a high integrity philosophy supported by proactive structures, principles, and systems to accrue "ethical capital." This will promote, monitor, and develop shared norms designed to identify and avoid potential conflicts of interest and abuse of office in any function of business (Cockburn et al. 2012) to benefit all stakeholders.

Corporate Governance Structure and MFIs

Studies by researchers highlight issues like board composition, characteristics, and MFI performance (Roberts, McNulty, and Stiles 2005; Thrikawala 2013) as factors for measuring good CG practices of directors and nonexecutive directors. These include board diversity, board size, director ownership, board compensation, CEO/chairman duality, education qualifications of board members, performance assessment of the board, number of board meetings, debt, and dividends (Bathula 2008;

Huse and Solberg 2006; Kyereboah-Coleman and Biekpe 2006; Roberts et al. 2005; Solomon 2004; Thrikawala 2013).

In addition, board diversity has become an entrenched issue in most CG discussions. The board diversity concept suggests that boards should reflect the true structure of society in which MFIs operate, with proportional representation regarding gender, ethnicity, and professional background of those within society. In addition, boards of directors of companies ought to have the right composition to provide diverse viewpoints (Milliken and Martins 1996). This is because board diversity strengthens moral obligation of shareholders commitment toward a common cause (Daily and Dalton 2003; Mattis 2000; Thrikawala 2013). Gender is considered as part of the broader conception of board diversity (Milliken and Martins 1996) since women constitute the majority of the stakeholder community of the microfinance industry who seem marginalized especially in developing countries.

Women directors are not as common as men in most corporate sectors but are usually external to corporate sector nonexecutive directors (Hillman, Cannella, and Harris 2002). Compared to men, most women directors possess managerial skills in specialized areas such as legal, public relations, human resources, marketing, communications, and so on. Several empirical works tested the effects of women being on the board of directors on organization performance (Farrell and Hersch 2005; Smith, Smith, and Verner 2006; Thrikawala 2013). According to Smith et al. (2006), women directors on boards have had a significant positive impact on firm performance. Carter et al. (2003) also find a positive relationship between gender diversity and firm performance and were concurred by Bassem (2009) who found that board diversity with a higher percentage of women enhances MFI performance. As much as female directors and other minorities are welcomed to champion the cause of GMFI, their background and capabilities must positively transform corporate leadership with integrity. They must be selected on merit, and must possess a results-oriented attitude for corporate growth.

Board Size

The size of boards is the number executives on corporate boards, and it is believed that the number of directors could affect the performance of a company, especially on its financial performance. Researchers propose that institutions with larger board membership contribute to high firm performance; thus, an increase in board size supports greater monitoring, and the firm's ability to network prudently with external environment (Adams and Mehran 2003).

Again, it is easier for larger boards to monitor managers' operations more effectively than smaller boards; thus, this makes it difficult for chief executive officers to control larger boards (Pearce and Zahra 1989). However, large board remuneration may negatively impact on the finances of firms especially SMEs operating in communities where board members are often remunerated. In the nonprofit sector, when a board has a higher number of trustees, it is easy for them to supervise most operational issues as they wield more power to control operational activities (Oster 1995).

Mersland and Strom (2009) observed that most MFIs have boards of seven to nine directors, while Bassem (2009) also contends that large boards with a range of expertise provide better performance for MFIs. However, Yermack (1996) points clearly that large boards are related to lower performance especially within the MFI sector. Furthermore, the appropriate number of board members has been a matter of continuing debate with mixed results (Dalton et al. 1999; Hermalin and Weisbach 2003); therefore, researchers are yet to determine a desired figure for board size. It can be observed that the number of members on a board influences a firm's performance as numbers affect the ability of the board to carry out its functions. Regarding the aforementioned discussion, the question that ought to be asked is whether large or small size boards are more appropriate for Ghanaian MFIs to thoroughly champion the cause of microfinance business. It is, therefore, clear that firm's performance is essential in the interest of all stakeholders. However, it is difficult to conclude whether the size of boards is perquisite for business success.

Independent Directors

The independence of the board of directors is another variable that determines the quality of board output without influence from powerful shareholders. Lorsch and MacIver (1989) postulate that there has been a growing predominance of outside directors who are there not only to provide a new perspective to top management's thinking but also to provide the right oversight only possible from an outsider.

Regarding the known agency theory, board independence and the balance between executive and nonexecutive directors on the board are critical for good CG evaluation (Bathula 2008). Lorsch and MacIver (1989) observe that 74 percent of directors are outsiders, and among them, 69 percent are non-management personnel with no other contacts with the organization. Hartarska (2005) used rated and unrated MFIs in Eastern Europe to investigate the relationship between CG and MFI success and concluded that more independent boards give better return on assets (ROA), whereas lower financial performance and outreach is observed for the boards with employee directors. Regarding the aforementioned argument, the question is: are board directors of MFI in Ghana and other developing world likely to be influenced by stakeholders?

CEO/Chairman Duality

Duality occurs when an individual plays dual roles at the apex of a firm performing CEO and chairman roles. Fama and Jensen (1983) note that firms that separate the two functions have improved performance. Agency theorists highlight that the separation of the roles of CEO and chairperson (Dalton et al. 1998) may be prudent in some situations. They argued that if the function of the chairman is to hire, fire, evaluate, and compensate the CEO, then this cannot be done when both roles are combined. This means that the chairperson's function must not be under the control of the CEO. CEO duality restricts the independence of the board and reduces the ability of boards to perform their rightful oversight and governance roles (Millstein and Katsh 2003).

In the MFI context, Mersland and Strom (2009) add that CEO/chairman duality has a positive influence on outreach of MFIs and when there is a female CEO this helps to improve a firm's financial performance. Furthermore, they added that they cannot prove whether MFIs are better governed when the CEO and chairman are separated. Therefore, it is important to use this characteristic to understand the power of firms, whether both important positions belong to one person or not. If both roles are performed by one person, boards of directors will be ineffective in discharging their monitoring duties, as opportunistic behavior by some CEO will reduce corporate performance. Thus, CEO/chairman influence on the board clarifies and the impacts a firm's performance. Similarly, CEO/chairman duality has impacted positively on firm performance due to prudent business decisions and monitoring mechanism (Allen and Gale 2000).

Ownership Type

Ownership type for MFIs is a shareholder firm that can be regulated by the banking authorities and remain independent from donors (Hardy, Holden, and Prokopenko 2003; Jansson, Rosales, and Westley 2004). Such MFIs will be able to benefit from CG due to private ownership. This underlines a need to transform not-for-profit MFIs to for-profit ownership (Ledgerwood and White 2006). Earlier some researchers have pointed out that most MFIs are now commercializing their institutions from not-for-profit to for-profit to enable shareholder firms to perform better than not-for-profit organizations (Hardy et al. 2003; Ivatury and Reille 2004; Ledgerwood and White 2006), and add that the solution is to provide low-cost credit to greater outreach (Varottil 2012). Hartarska (2005), Mersland, and Strom (2009) and Sinclair (2012) indicate that for-profit organizations' ownership structure does not advance MFIs' performance. Further, Mersland and Strøm (2009) reveal that the ownership of MFIs does not matter for firm performance since what is required is the professional contribution of board members to deliver through managements and employees. However, the relationship between a firm's performance and ownership cannot be overemphasized since share value of companies can only appreciate through prudent business performance.

The Case Investigation

The researchers used the case study strategy being a deliberated and intensive examination of a few selected cases of phenomenon interest to researchers (Malhotra 2009) to investigate the microfinance phenomenon in Ghana. Case study is a contemporary research phenomenon based on a real-life situation in social science (Hinson and Mahmoud 2011;

Yin 1994). Research methodology and a philosophical underpinning behind the study helped the researcher to highlight the choice of an appropriate research technique to actualize their findings through prudent data collection and analysis (White 2000). Employing the qualitative research strategy for the study, the researchers drew respondents from the population of MFIs as classified by the Central Bank of Ghana (BG/GOV/SEC/2011) and other stakeholders in the country. The sample comprised of 25 respondents from the Greater Accra Region made up of a cross section of Ghana's microfinance stakeholders, including managers, customers, members of academia, and advocates. In addition, the purposive sampling technique was employed to select respondents considered as essential and strategic stakeholders to the study (Creswell 2012; Malhotra 2009). These respondents were key informants to the study, since they possess desired information about the research theme, hence were considered in the study (Kumar et al. 1993).

Data Collection

In all, 16 out of 25 respondents representing (64 percent) are described as key informants and availed themselves for qualitative interviews. Questions posed during the interviews were in line with various theories (Mersland and Strøm 2009; Mersland 2011; Varottil 2012) on CG and CEO/chairman duality, McNulty, and Stiles (2005) on board composition of MFIs. The interviews were recorded, coded in line with the research theme, transcribed and analyzed using thematic qualitative data analysis approach as prescribed by Braun and Clarke (2006) having taken ethical issues into consideration.

It must be emphasized that the sample selected can be described as adequate compared to earlier researchers who depended on fewer samples. For example, Omar (1997) used 12 respondents; Doherty (2000) depended on 7 respondents; Sen (2006) worked with 7 respondents; and Hinson and Mahmoud (2011) used 14 respondents in their studies. Therefore, using 16 respondents in this study can be considered highly adequate for investigating the phenomenon of microfinance in a developing country like Ghana where information gathering is often difficult (Ofori and Hinson 2007).

Table 11.1 Profile of respondents

Institution	Number of Respondents	Position	Responsibility
Rural Banks	3	Management	Strategy development, customer relations, and general management
Universities	3	Faculty members	Lecturing, research, and consultancy
Savings & Loans	3	Management	Administration, marketing, and microfinance operations
Customers	4	2 Retailers and 2 individuals	Trading
MFI Expert	1	CEO	Advocacy and consultancy
MFIs	3	Management	Operations
Credit Union	1	General manager	General administration and strategy

Field Data: 2014.

From Table 11.1, respondents comprised of three rural bank managers responsible for strategy, customer relations, and general management. Also involved were three university lecturers, one being an expert of microfinance. There were three savings and loans managers responsible for finance and administration, marketing, and microfinance. In addition, there were four customers of MFIs, one microfinance expect, and finally three managers of microfinance in charge of operations. Regarding gender, there were nine males and seven female respondents.

Interview Questions and Findings

The majority of respondents gave a positive report about Ghana's MFI sector, describing how the sector has impacted the country's financial services sector; but quickly added that, despite the positive gains, some players in the sector were taking undue advantage of the poor unbanked customers they serve (Table 11.2). A member of academia and a customer simply put it as ". . . MFIs seem to have created awareness in the banking sector especially for the unbanked population including low income . . .. but MFIs are highly exploitative operating with high interest rates and short term loans . . ." This was concurred by a microfinance expert saying interest rates of MFIs are high, therefore failing to impact on SMEs as

Table 11.2 Assessment of Ghana's MFI sector

Question	Respondent	Response
What is your general impression of Ghana's MFI sector?	Customer	Positive impact, but some are taking undue advantage of poor customers.
	Member of academia	MFIs seem to have created awareness to bank the nonbankable but are highly exploitative with high interest for short-term loans.
	MFI expert	Interest rates of MFIs are high and therefore failing to impact on SMEs as expected.
	General manager	The sector is vibrant and may be the fastest growing sector in the economy with a broad range of financial products for their targets.

Field Data: 2014.

expected. However, a manager of a credit union submits that ". . . the sector is vibrant and may be the fastest growing sector in the economy with broad range of financial products for their targets . . ."

Most respondents demonstrated a sound understanding of the subject showing clearly the essence of CG and business growth (Table 11.3). For example, when the question was put, two respondents added that ". . . corporate governance enhances business practice and performance since it leads to reduction of losses . . .". This was further supported by another respondent saying "corporate governance is key in every business

Table 11.3 Opinions on CG and business practice in Ghana

Question	Respondent	Responses
What is your opinion on CG and business practices in Ghana?	Member of academia	CG enhances business practice and performance since it leads to reduction of losses.
	MFI expert	CG is key in every business sphere since businesses cannot achieve their purpose and existence if CG structures are flawed.
	Management of MFI	Every institution needs to follow due process and procedures to ensure that firms are managed properly in line with owners' vision, mission, and operating objectives, which can be achieved through adherence to good CG structures.

Field Data: 2014.

sphere since businesses cannot achieve their purpose and existence if corporate governance structures are flawed." Another further added that ". . . every institution needs to follow due process and procedures to ensure that firms are managed properly in line with owners' vision, mission and operating objectives which can be achieve through adherence to good corporate governance structures . . ."

Response to the question in Table 11.4 was largely in the affirmative as all respondents in the study positively indicated that business organizations including MFIs in Ghana need proper structures on CG. Putting it clearly, one respondent added that "all institutions no matter its size need some form of corporate governance to enhance its operations since soft values like code of conduct is crafted and approved by boards of companies." A member of academia supports that, " absolutely . . . external and internal CG structures will ensure better and more professional business practices and such a system will also ensure that regulations are being adhered to, policies are being followed and ultimately forcing MFIs to work toward poverty alleviation and not just profits . . ." This was also concurred by another rural bank manager that "corporate governance is the basis for proper separation of roles and responsibilities of all internal

Table 11.4 Using CG to enhance MFI operations in Ghana

Question	Respondent	Responses
Could CG be used in microfinance in Ghana and why?	Member of academia	All institutions need CG to enhance its operations since soft values like code of conduct is crafted and approved by boards of directors.
	Management of MFI	External and internal CG structures will ensure better and more professional business practices and such a system will also ensure that regulations are being adhered to.
	Customer	CG is the basis for proper separation of roles and responsibilities of all internal stakeholders.
	Member of Academia, manager of Savings & Loans Co., and a customer	Yes. Ghana's MFI sector needs strong CG structures to attract a lot of investors due to public confidence.

Field Data: 2014.

Table 11.5 Poor CG structures and the collapse of some MFIs in Ghana

Question	Respondent	Responses
Could the collapse of MFIs in Ghana be attributed to poor CG structures and why?	Customer of MFI	High inflation and lending rates, exchange rates, and high unemployment leading to low purchasing income have also contributed to the phenomenon.
	Management of MFI	Poor regulatory controls within and outside the sector calls for enforcing best practices and lays credence to the state of affairs.
	MFI expert	The sector in Ghana is challenged with inappropriate institutional arrangements, poor regulatory environment, and inadequate capacity in the form of skills and capital, conflict of interest, and lack of good corporate structures for MFIs.

Field Data: 2014.

stakeholders . . .” Finally, another member of academia and a savings and loans manager and a customer, respectively, added that “. . . Yes Ghana’s MFI sector need strong corporate governance structures to attract a lot of investors since public confidence is low . . .”. Good CG serves the interest of investors and customers, which are all outlined through governance policies and processes.

The response to the question in Table 11.5 was mixed as some respondents answered in the affirmative, while others responded in the negative. Specifically, responses such as “partly,” “yes to some extent,” and “not really” were common. However, a manager of a microfinance firm observed that adverse economic factors like “high inflation and lending rates, exchange rates, high unemployment often leads to low purchasing income have contributed to the phenomenon.” Others also observed that “. . . poor regulatory controls within and outside the sector calls for enforcing best practices and lays credence to the state of affairs . . .” A microfinance expert finally concluded that “. . . the sector in Ghana is challenged with inappropriate institutional arrangements, poor regulatory environment, and inadequate capacity in the form of skills and capital, conflict of interest and lack of good corporate structures for MFIs . . .”

If MFIs were to incorporate good corporate governance ideas, what type of people should they appoint on their boards and how many should be appointed?

The following caliber of individuals were recommended by respondents as appropriate for appointment onto boards of MFIs and comprise of people with marketing, finance, accounting, human resource as well as legal backgrounds. Others include successful entrepreneurs, business professionals, and donors or investors. Again, respondents also recommended five, seven, and nine as appropriate numbers to be appointed onto boards of companies.

What is your opinion about board chairs of MFIs simultaneously playing leading roles like CEOs?

From the study, the majority of responses captured were as follows: ". . . it is better to separate the two roles due to possible conflict of interest . . ." and as indicated by some respondents, ". . . it affects controls hence board chairs should be different from CEOs . . .". Those in the minority added that some MFIs operate like sole proprietor business; hence, it will be difficult to separate the two roles.

What is your opinion on gender and appointment of board of directors of MFIs in Ghana?

The responses to this seem mixed since various respondents expressed their opinion; however, some respondents advocated for the appointment of qualified professionals especially women of corporate boards of MFIs in Ghana. According to some, ". . . It does no matter who is appointed provided the person is capable for the task . . ." Others observed that it would be appropriate to appoint more women to the boards of MFIs since most customers of MFIs are women with children who are the vulnerable in society: ". . . more women bank with MFIs and it would be right to appoint women directors . . ." A respondent observes that ". . . it does not matter who is appointed on boards provided the person ensures that the right thing is done professionally to safe guard interest of key stakeholders like customers and investors . . ."

Should it be mandatory for all MFIs in Ghana to show evidence of board members before being licensed by the Central Bank and why?

All respondents indicated in the affirmative that it ought to be a prerequisite for all MFIs to show proof of existence of board members before being licensed by the Central Bank. A member of academia who is also a microfinance expert clearly added that ". . . it would be too good and it should not be just evidence but there should be criteria of who qualifies to be on the board with their background taken into consideration . . .."

Other managers of MFIs added that ". . . to avoid deception on the part of MFIs and safeguard the interest of investors, the public, the background of these individuals must be verified by security agencies . . ."

Are there any challenges associated with corporate governance and MFIs in Ghana?

Responses to this were varied among respondents; one respondent indicated ". . . difficulty to constitute independent boards . . ." and ". . . low quality staff . . ." However, majority of respondents added that poor regulation of the sector by the Central Bank has negatively affected operations of MFIs and are calling on the regulator to enforce the law through board of directors and other governance policies.

Conclusions and Recommendations

From the study, it is evidently clear that the role of MFIs in a developing country like Ghana cannot be overemphasized as they have revolutionized the country's financial services sector. MFIs have succeeded in creating the desired awareness by banking the nonbankable population, thereby supporting low-income clients classified as poor to come out of extreme poverty with the provision of microfinance products to achieving MDG goal one. The study clearly justifies the fact that the MFI sector is one of the fastest growing sectors in Ghana and the developing world. Furthermore, the study reveals that some MFIs were taking undue advantage of poor clients by charging high interest rates on loans because of profit motives, thereby exploiting low-income customers due to laxity in enforcing governance laws. The sector is currently suffering from poor governance structures which allow unscrupulous MFIs to exploit poor.

Finally, it is obvious that all businesses including MFIs, ought to have appropriate CG policies to achieve their aim. Despite the benefits of good CG as discussed, some MFIs in Ghana have no regard for regulatory laws due to the laxity in regulatory powers of the Central Bank. Poor regulatory enforcement has forced some MFIs to fold up to the disadvantage of the poor clients whose meager savings cannot be recovered.

To enhance good CG in business among financial services and to benefit all key stakeholders, especially low income customers, regulators must up their game by enforcing all regulatory policies to inspire public confidence, improve financial intermediation, and safeguard interest of depositors and investors. Stringent policies must be formulated to compel owners and managers of MFIs to operate within sound government policies. Board compliance requirements consisting appointment of quality of board of directors must be considered. In addition, strong internal and external controls systems must be followed to safeguard the interest of all stakeholders including customers. MFIs must fully computerize their operations as a control measure and to provide prompt service. Finally, directors with marketing and customer oriented backgrounds must be appointed as board superintendents to pursue the interest of bottom of the pyramid clients for sustainable business, customer satisfaction and to achieve MDG goal one of eradicating extreme poverty and hunger.

For future study on the subject area, it is recommended that studies should be conducted using the quantitative research or mixed research approach to measure the extent of CG among MFIs and how CG impacts positively on the marketing decisions of MFIs especially among developing countries measuring the impact of professional marketing practices on the benefit of low-income clients.

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Discussion Questions

1. From the discussions, what is your candid opinion about the microfinance phenomenon and how it influences the lives of low-income/unbanked customers?
2. Would you say that good CG is a prerequisite for microfinance operations especially those operating in developing countries and why?
3. Which governance model or structure would you recommend for the microfinance companies and why do you think your proposed model or structure is the best?
4. What are the future prospects of microfinance activities especially in the lives of low "unbanked" customers considering the fact that commercial banks may venture into microfinance because of increasing competition in the banking sector?

Authors Biographies

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Vida A. P. Dzogbenuku holds a BEd in special education and an MBA in entrepreneurship and small-business development from the University of Education, Winneba, and the University of Cape Coast, respectively. Vida is currently a director of Special Education at Ghana Education Service and also manages Vinevid Foods Brands in Ghana. Her research interests are in entrepreneurship and small-business innovation.

CHAPTER 12

Multistakeholder Committee for Sustainable Innovation: Creating an Ethical Code in the Jewelry Business. The Experience of the Italian Ethics Committee of Color Gemstones (Assogemme)

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Abstract

Collaboration, contamination, and wide participation are the common denominators of innovation and sustainability. This work aims at studying engagement as the basis for innovative projects that respond to an objective of social and environmental sustainability, and describes the multistakeholder committee as the ideal container for realizing the engagement.

The collaborative sustainability is defined as an effective and credible action for the creation and dissemination of sustainability of the supply chain. This chapter explores the experience of the Ethics Committee of Color Gemstones, by Assogemme, in Italy, analyzing its planning and

operation activities. It is set up with the aim to produce a sustainable innovation process, aimed at the creation of "new" standards for traceability of jewelry products made with color gemstones, and at the definition of an ethical code for the companies of this business.

Keywords: co-sustainability, co-innovation, multistakeholder committee, jewelry business.

Innovation and Sustainability: Focusing on *Stakeholder Engagement*

Both in literature and in "laboratories," innovation and sustainability are resorting more and more to models of collaborative involvement of resources for the exchange of skills, referring therefore to the perspective of *stakeholder engagement*. This perspective asserts a core value: the position of responsibility required of firms and stakeholders in order to engage in the sharing of information, in the construction of a dialogue, and in an ongoing commitment to solve problems together (Svendsen and Laberge 2005). The relational aspect is therefore a key element; the creation and subsequent consolidation of the *social capital* of the company is strategic, because it represents the "glue" that holds together the social relations (Burt 1997; Putman 2000; Ayios et al. 2013).

In other words, the key items that make this approach possible are as follows: participation, expanded participation, sharing (of information and dialogue), and engagement with the goal of building a relationship and solve a common problem.

In terms of innovation, *open sources* and *open innovation* are inspired by this perspective. The first emphasizes the exchange to innovate, and the second, which was formalized by Chesbrough in 2003 as opposed to the *closed innovation* concept, emphasizes the need for businesses to be open to buying or selling knowledge, assessing which information to gain and which one to sell out through the most appropriate forms (patents, license agreements, spin-offs, etc.).

The focus on the increased complexity of knowledge processes, which are the backbone of new technologies and innovation, leads firms to search beyond their own boundaries for valuable knowledge and skills in order to complement their own capabilities (Becker and Dietz 2004). Starting from this perspective, some studies have underlined the positive effects of accessing complementary technological resources (such as skill sharing). Such resources can contribute to a faster development of innovations, an improved market access, economies of scale and scope, cost sharing, and risk spreading (Ahuja 2000; Cassiman, Veugelers 2002; Hagedoorn 2002; López 2008), as higher overall performance levels (Abramovsky et al. 2008) and a higher R&D intensity (Becker and Dietz 2004; Sampson 2007) since they are able to share investment, costs, and may take advantage of partners' resources and capabilities, an increase of the profitability of R&D (Belderbos et al. 2003).

Another theoretical path is the attention given to the collaboration among all types of companies, large and medium–small enterprises (Hagedoorn, Albert, and Vonortas 2000), or to the ability of large firms to manage spillovers. Firms involved in R&D cooperation tend to be relatively large and have a high share of R&D expenditures (Fritsch and Lukas 2001). This agrees with Negassi's findings, where R&D increases with size and R&D intensity (Negassi 2004). Regarding the actors of the product line, some studies have underlined that vertical spillovers, associated with suppliers and customers, have a more significant effect on the R&D performance and welfare than horizontal spillovers, which are linked to universities, research institutes, and competitors (Atallah 2002). In addition, cooperation with customers and public sector institutions is positively related to the success of product innovations, and the cooperation with suppliers and universities has a more significant influence on the success of process innovations (Freel and Harrison 2006).

Other research paths examine innovation cooperation strategies, distinguishing those companies that follow an incremental path build on the firm's existing internal knowledge from those that provide knowledge to aid defining trajectories that are new to the firm (Bercovitz and Feldman 2007); in the latter case, collaboration with universities and government labs is the most common examples.

Cooperative arrangements for innovation are more common among firms that introduced innovations that were new not only to the firm, but also to the market. Furthermore, the intensity of R&D activities tends to increase the likelihood of a firm having cooperative arrangements for innovation with external partners (Tether 2002). The search for external partners is normally associated with more complex innovation processes, e.g., those that combine both process and product innovation (Piga and Vivarelli 2004). Regarding the complexity of innovation process, Bayona, Garcia-Marco, and Huerta (2001) and Miotti and Sachwald (2003) provide evidence that the firms operating in more technology-intensive sectors have a greater propensity to establish cooperative R&D and innovation agreements. Dachs, Ebersberger, and Pyka (2008) also observe a relation with the speedier processes of knowledge generation and use.

A good review of these different perspectives is found in a study (de Faria, Lima, and Santos 2010), which analyzes the importance of cooperation partners for the development of innovation activities as well as the determinants of this development.

Even in relation to the issue of sustainability, there is a strong reminder in the literature, and not only there, of an action of engagement of stakeholders. Acting responsibly means supporting investments and costs, as well as forming appropriate skills, which are often unaffordable actions for a single actor, especially for a small- and medium-size firm. Many are the sources in which it is suggested to implement strategies for corporate social responsibility (CSR) based on a cooperation between companies and institutions, either local or national (Pulci and Valentini 2003; Del Baldo 2009), partly because the wide participation of more actors will enable the development of larger projects. This will allow these actors to enjoy the benefits deriving from them, both inside—for the companies belonging to them—and outside—for the beneficiaries of projects (Piciocchi, Vollero, and Palazzo 2009; Cesaretti and Annunziata 2011). The expanded involvement stimulates the exchange not only of skills, but also of instances and needs; it legitimates projects and provides them with the necessary conditions to be developed and effectively achieve the estimated results. They are the conditions that are defined by some authors as a *relational state* (Mendoza 1996; Albareda, Ysa, and Lozano 2004; Midttun 2005), or by others, from a different perspective, *collaborative governance* (Zadek 2006), or even *corporate responsibility and responsible competitiveness clusters* (Zadek et al. 2003; Sancassiani et al. 2007). Moreover, it was noted that the intensity of the "mechanism of contamination" between different actors belonging to the network and the "modalities of communication" affect the ability of the individual components to implement structured systems of sustainability and influence the degree of social responsibility of other actors in the network (Caroli and Tantalo 2011).

With particular reference to SMEs, the literature suggests to act through an approach based on the local network, where these actors can take advantage of the opportunity to act as a metaorganization, while institutions can play a key role as intermediary for the promotion of joint strategies inspired by social responsibility (Antoldi, Cerrato, and Todisco 2008; De Chiara 2012). Also the institutions, noting the lack of adoption of instruments for CSR, which was mainly motivated by the difficulties encountered by companies in relation to cultural and financial aspects, suggest to create a scenario for small business based on a dialogue with stakeholders (UNIDO 2007).

The creation of a network also seems to be an appropriate way to develop the necessary skills to help the interpenetration of social responsibility in defining business strategies, thereby making sustainability an integral part of the strategy also pursued by individual companies (Molteni, Pedrini, and Bertolini 2006). However, we must be aware that the direction given by the network is inevitably affected by the space–time contextualization of operational activities from the network, as well as by the technical and organizational aspects of the production processes, with the important consequence that no solution can be assumed as a standard that is replicable in all production chains and in any territorial context (Del Baldo and De Martini 2012). The network that develops active mechanisms of participation manages and governs the institutional socioeconomic fabric, and allows to recover and strengthen the identity elements of the territory in which it operates (Del Baldo and De Martini 2012).

A particular line of research analyzes the collaboration among the actors in the supply chain in terms of sustainability: *logistics social responsibility*, *purchasing social responsibility* (Carter and Jennings 2002), as well as *sustainable supply chain management* (Teuscher, Grüninger, and Ferdinand 2006) are some approaches that emphasize the effectiveness of the adoption of CSR practices in a collaborative approach to management, aimed at involvement of stakeholders at different stages of the implementation process (Maignan, Hillebrand, and McAlister 2002; Vurro, Russo, and Perrini 2009). The supplier plays a strategic role in the implementation and success of the strategy of CSR (Murphy and Poist 2002; Carter and Jennings 2004; Carter and Rogers 2005; *Andersen and Skjoett-Larsen 2009*; De Chiara and Russo Spena 2011); moreover, it is considered the best practice to develop CSR strategies in consultation with the main suppliers and other stakeholders in the community of a firm (Waddock and Boyle 1995).

The engagement appears to be functional to the creation of a climate of confidence, reduction of costs associated with trade, and improvement in the effectiveness of the actions (Cox 2004; van Tulder, van Wijk, and Kolk 2009; Russo Spena and De Chiara 2012).

"Co-sustainability"

The engagement is an essential activity for a company that more and more expresses a social function. There are many theoretical positions that emphasize how the company today can only be seen as a "social process in which an economic process is realized" (Bartels 1967); therefore, it must be founded on the combination of "sociality and economy" (Sciarelli 2007), and the social responsibility is a fundamental component of "being and of doing business" (Caselli 1998).

Regardless of the definition of a company that one wants to adopt (*collection of resources*, *open system* of socio-technical type, and *set of tasks* addressed to the satisfaction of human needs), there is no doubt that a company finds its reason of being in the bundle of relations that it must activate, internally and externally, to perform its function (De Chiara and Delli Carpini 2009).

Collaborating with stakeholders to pursue sustainable behavior triggers the participatory process that allows it to reach the formulation of shared objectives and actions, so that—first of all with regard to the actors of the supply chain—liabilities, costs, and benefits are well balanced throughout the production chain. Also by expanding the range to include in the participatory process the market, the institutions, and the entire community, a joint and shared action can be achieved by all stakeholders with the aim to pursue sustainability projects directed to a common goal, which could be defined as system sustainability.

By collaborative sustainability, co-sustainability, it is meant therefore:

1. A pattern of behavior common to most economic actors, inspired by sustainability, that is to say to those cardinal principles of environmental protection and human rights, as well as declined in the international codes of conduct (Green Paper of EC, Guidelines of OECD) designed and implemented within B2B relationships, or network of companies belonging to the same chain or chains that are intertwined in the production of semifinished and/or finished products.

   Among the participating actors, this model is supported by the exchange of knowledge and skills, which not only stimulates the members of the network to the research and implementation of better solutions, but it will especially avoid dystonias in actors' behaviors that would undermine the effectiveness of the project and achievement of the goal of sustainability.

   In fact, the credibility of a sustainability project in relation to a product/service or process regards its impact in terms of an actual effect on the whole community. Therefore, a wide participation, such as those involved in the supply chain, will prevent the reduction or cancellation of a company's impactful actions by the unethical behavior of other actors belonging to the same chain.
2. The collaborative behavior addressed to a sustainable project, which allows a wide participation of stakeholders—including also the institutions and the community—will really foster high-impact initiatives; it will allow to share objectives and actions to be implemented with the ultimate aim of achieving a really common good.

The importance of engagement of stakeholders is supported by a wide literature and, in the perspective of a shared sustainability project, many studies emphasize the importance of moving to a systematic management of the supply chain based on trust, safety, traceability, and strong partnerships with stakeholders, from suppliers to distributors and, finally, to the end customers (Perrini, Pogutz, and Tencati 2006;

Perrini, Russo, and Tencati 2007; Russo and Tencati 2009). In many cases, however, the collaboration, even if enlarged, is not sufficient and, as it has been pointed out from the perspective of *Collective Impact*, "large-scale social change requires broad cross-sector coordination a commitment of a group of important actors from different sectors to a common agenda for solving a specific social problem" (Kania and Kramer 2011, 36).

Participation, sharing, organization, and coordination are essential to accomplish an act of collaborative sustainability. The aim is creating a "learning alliance," in which a range of stakeholders—typically located at different levels and within different domains but connected by a common interest in promoting inclusion—come together as a group to optimize relations and break down barriers to learning. It is an opportunity to create new relationships and networks in which a group takes collective action to address an issue, to solve a problem, or to assess new opportunities in the field of sustainability.

This alliance may be structured as a multistakeholder committee, a container that is used to exchange skills, share experiences, and start a process of participation in decision-making processes that already appears as a first important result, since it represents a learning experience for all, which can then affect the action planning. The process of participating in a multistakeholder committee, sharing experiences and taking part in decision-making processes, and debating on the selection of good practices and the direction of the project will be an empowering process and a learning experience for all members. The committee, going through the process of working together and of identifying change and solutions, will increase its ability to work together. This kind of collective action is based on dialogue, participation, and empowerment.

The processes of setting up and running a multistakeholder group should have as its starting point the definition of the purpose, or rather of the project, identifying the objectives on the short and medium term. This base is needed to start a process not only of discovery, but also of imagination and of the type of knowledge and expertise that the committee needs. This knowledge leads to identifying organizations or persons in possession of the necessary skills, and it should also take into account both the research institutions and civil society groups that have expertise on the project.

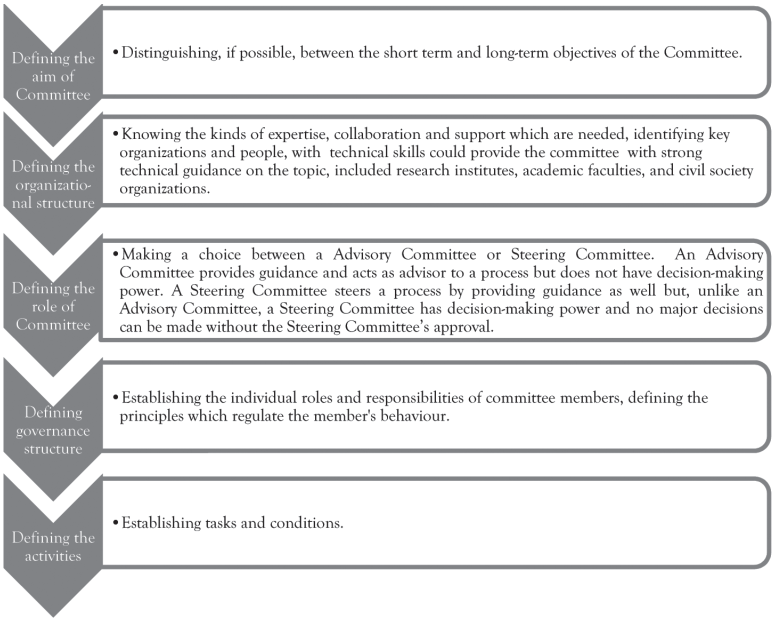

Figure 12.1 Several steps for the establishment of a multistakeholder committee

The next step involves the definition of the role of the group that has formed, by distinguishing task support and supervisor processes role (advisory committee) from a more complex task of defining the decision and approval of proposals brought to the discussion (Steering Committee). Finally, the roles and responsibilities of the individual participants in the group would be defined by answering the question on how each member can contribute, in order to outline the governance structure. This has the important task of the government of the committee; it must define the rules and processes by which decisions are made, but first it has to define the principles that inspired the components, which ensure an effective collaboration. Moreover, the activities to be carried out by the committee should be defined, as well as its mode of operation. Therefore, for a multistakeholder committee to function effectively, there are key steps that should be taken in order to engage all members of the committee and to provide the base for an effective participatory body (Figure 12.1).[1]

[1]For deeper details, see: Making it Work. "Facilitating multi-stakeholder involvement," www.makingitwork-crpd.org (January 2014); Revit. 2006. *Stakeholder Engagement—A Toolkit*, www.revit-nweurope.org (January 2014).

Empirical Research

Why the Jewelry Business?

The decision to investigate the co-sustainability and also describe the operation of the multistakeholder committee for the resolution of the best practices in the context of sustainability is attributed to the experiences that are taking place in gold and jewelry business. This business presents high ethical issues, which in part go back to the structural characteristics of the jewelry industry, such as: (1) a strong dispersion of the activities of the value chain—from the goldmines, mines of diamonds and platinum situated in Africa, Canada, Australia, and Russia, cleaning and processing activities in India, China, and Turkey, to distribution in the United States, European Union, Japan, and the emerging markets of China and India; (2) a strong separation between the decision-making activities that, especially in diamonds industry, are concentrated in the hands of a few large firms of developed countries, and the operations/production activities, in which prevails a strong fragmentation with a localization of production sites especially in emerging countries and in the developing ones. In addition to fragmentation of activities and dislocation of the same in strongly contrasting areas, there are two more kinds of problems: the presence of operators belonging to different cultural value systems, which, therefore, affects the interpretation of the significance of the principle of social and environmental sustainability; and the heterogeneity in the composition of the operators, which generates a diversity of patterns of behavior, as well as the risk of establishing a breeding ground for the onset of action of power by large corporations against small operators of the supply chain.

The sector of the jewelry is exposed to strong ethical risks, in the dual role of environmental pollution and human rights violations,[2] which has requested several proposals to achieve a responsible chain of gold, diamond jewelry, and other precious stones. In these initiatives, it is possible to find examples of co-sustainability and multistakeholder committees,

[2]Columbite-tantalite, also known as coltan (from which tantalum is derived), cassiterite (tin), gold, wolframite (tungsten), or their derivatives, are conflict minerals; minerals mined in conditions of armed conflict and human rights abuses, and are regulated by U.S. Conflict Minerals Law.

which are designed and developed envisaging the enlarged participation of stakeholders and the sharing of objectives and actions for the development of standards/certification systems of gold and diamonds.

So is the experience of the *Kimberley Process*, the agreement finalized and approved by the joint efforts of the governments of many countries involved in the extraction of diamonds, multinational manufacturers of diamonds, and civil society. Institutionalized in November 2002, following the approval of the United Nations (13 March 2002), the *Kimberley Process Certification Scheme* (KPCS), which takes its name from the town of Kimberley in South Africa where, in May 2000, the representative members of the different categories of stakeholder met, is a certification system to trace diamonds and to ensure that they come from legitimate mining equipment. Currently, this certification system is the most effective tool to protect the diamond industry and above all to ensure that the profits generated by this activity can also benefit local communities and the individuals who work there, assuming that the diamond is a natural resource and should bring benefits to all stakeholders. The system also allows to avoid that the extraction can finance the purchase of weapons and fuel conflicts as well as civil wars, and can cause serious human rights violations, which was a rather common situations, prior to the agreement, so much so to coin the definition of *blood diamond* or *conflict diamonds* (UN 2001).

Even the experience of the Responsible Jewellery Council—the international nonprofit organization founded in 2005 that contains a growing number of companies operating in the sector of jewelry (diamonds, gold, and platinum group metals)—has the aim to build a responsible supply chain for diamonds, gold, and platinum group metals, "from the mine to the consumer." The organization has developed a reference framework for the sector by creating a series of standard *Code of Practices* and *Chain of Custody* to promote responsible business practices and standards. These results have been achieved through the work of the RJC Standards Committee, a committee with 14 members, so composed: "elected RJC Member representatives, two from each Member Forum, and up to 12 external participants from NGOs, related standards organizations and other experts."[3]

[3]Responsible Jewellery Council. "RJC Standards Committee". www.responsiblejewellery.com (January 2014).

Multi-stakeholder Standards Committee—Representatives from each part of the supply chain, civil society, other standards organisations and independent experts working towards consensus.

Collaboration—Alliance for Responsible Mining, Diamond Development Initiative; Solidaridad and Swiss Better Gold Initiative on responsible gold sourcing from mine to jewellers; London Bullion Market Association (LBMA) and Conflict-Free Smelter program – audit harmonisation for gold refiners.

International initiatives—RJC strongly involved in development of the OECD Due Diligence Guidance for conflict-affected areas, and now appointed to the OECD's Multi-Stakeholder Steering Group for the Guidance.

Figure 12.2 Responsible jewellery council characteristics

Source: Responsible Jewellery Council

The committee designs, implements, and continuously improves the RJC Certification, as well as "provides policy advice on the consultation and engagement of stakeholders during standards development activities" (Figure 12.2).

Another important experience of co-sustainability is that of the Organization for Economic Cooperation and Development (OECD), which drafted the *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-affected and High-risk Areas*, a guide that offers suggestions for the responsible management of global supply chains of minerals, in order to help companies to respect human rights and do not contribute to conflict through their activities. The OECD has developed a specific supplement to the mining activity in the gold sector and, also in this case, it works in the form of a working group, formed to "OECD, ICGLR and other partner countries, international organizations, industry at several levels of the gold supply chain, international and local civil society organizations, expert consultancy groups and other independent experts" (OECD 2011). In the official documents it is declared: "This work is the first example of a collaborative government-backed multi-stakeholder initiative on responsible supply chain management of minerals from conflict-affected areas" (ibidiem, p. 1).

The multistakeholder committee had the task to discuss the first draft of the *Supplement on Gold* and has received great appreciation from the participants for its mode of constitution. The importance of a broad participation for the success of the project has been repeatedly reaffirmed by the same committee that has declared: "(. . .) some stakeholders that would be vital to the success of due diligence efforts for conflict-free gold supply chains should be invited to participate in the OECD-hosted working group on gold. Participants considered it a priority to invite key non-member countries and companies in the gold supply chain based in those countries. It was clarified that relevant non-OECD countries had been invited. (. . .) such as customs authorities, finance ministries and central banks, should participate to share their relevant expertise" (ibidiem, p. 5).

Empirical research has therefore focused on this sector, choosing to analyze the experience of the Ethics Committee of Color Gemstones, of Assogemme, in Italy, through the study of documents (regulation, verbal) made available by the committee and carrying out talks with the president of the committee.

The Experience of the Ethics Committee of Color Gemstones, Assogemme

The market for colored gemstones is worth U.S. $10–12 billion a year and 80 percent of it comes from small-scale mines: the supply chain from the mine to the market is highly fragmented with a high degree of opacity. The high value of the gems makes illegal activities likely, which are often characterized by the involvement of criminal groups (UNICRI 2013).

In order to contain this risk in Italy, Assogemme (at Confindustria Rimini) has launched the Ethics Committee of the Color Gemstones (Figure 12.3) whose main objective is "(. . .) to prevent that in the supply chain occur exploitation of minors and workers in general, while ensuring fair wages and healthy workplaces. These objectives are only apparently simple, because their achievement is made very complex by the immense extension of the supply chain and production areas" (Paolo Cesare, president of Assogemme).

Goal	• (sec.3) Drawing up of a procedural code related to the production and marketing of the color gemstones according to the principles of ethical conduct.
Composition	• (sec. 2) The Committee consists of: President (Dr. ssa L. La Via); Secretary of the Committee (dott.ssa S. Cialotti); President of the Scientific Committee (Dr. L. Costantini); Vice President of Scientific Committee (Dr. A. Scarani); Scientific Committee (Dr. P. Minieri) The members of the Committee, appointed by the Board of Directors of Assogemme, will be members of the association and they are sensitive to the ethical process of commercialization and use of gems (dott.ri A. Santini, D. Bruni, M. Falezza, S.Cortecci, G.Torcolacci, A. Cesari, C. Cerasi, M. Brandigi, P. Cesari, M. Bonini, S. de Pascale).
Tasks	• (sec.9) Duties of the Committee: 1 . Defining the Scope of Application of the code of ethics; 2 . Defining materials , chain of production, actors in the production chain , (subjects and objects) of the code of ethics; 3 . Enunciation and definition of ethical principles underlying the code of ethics and its practices; 4. Defining of ethics and procedural code; 5. Aim and purpose of the code of ethics; 6. Purpose of the code of ethics: a. Assessment and monitoring of socio-political conditions of the countries of origin of the gems , b. Assessment and monitoring of socio-economic conditions in the sites of origin and transformation of the countries of origin of color gemstones, c. Assessment and control of the conditions of legality and transparency in the countries of the chain (producers, processors, exporters, importers) ; 7. Procedural methods for the investigation (a.Feasibility b. Operation); 8. Mode of presentation of the finished product to customer.

Figure 12.3 Features of the ethics committee of the color gemstones of assogemme

Established on July 17, 2013, the committee is promoted by Assogemme, in the person of its president, and in its initial composition it is an expression almost exclusively of the jewelry industry. Among its participants, there are testimonials from leading companies such as Bulgari, Gucci, Pomellato, and Bruni, some members of the SMEs for the production of jewelry, members of the scientific world, which represent the scientific committee within the ethics committee, made up of gemologists, and finally the representative exponents of the major industry associations, Assogemme, Responsible Jewellery Council, Federorafi.

In the setting phase, these expertise can be classified into three types: the specific business, gemological scientific research, and business institutions with characterizing features of the jewelry industry.

The committee has adopted a "Regulation for the operation of the Ethics Committee of the Color Gemstones," which in section 1 (Scope of the Rules) defines that "The present rules govern the activities of the Ethics Committee for the Color Gemstones as part of the Italian Association of precious stones and similar 'Assogemme.'"

The purpose of the committee, set in section 3 (Purpose), is the "Drafting of a procedural code related to the production and marketing of the color gemstones according to the principles of ethical conduct." It is therefore a committee with a role of steering committee, namely, the definition of the decisions and approval of proposals brought to discussion by the working groups. Section 9 (commissions and working groups) defines that "In carrying out its activities, the Committee can work in committees or working groups (. . .) the President, after consultation with the Committee, may designate a person responsible for individual components or areas of expertise of the Committee."

At its establishment, the governance of the committee consists of the president of the ethics committee, the secretariat, and two subcommittees: one called "scientific committee," with a president, a vice chairman, and members who belong to it, and another that includes the major brands of jewelry, also organized with a chairman and a vice president.

In the regulation of the professional relationship between all participating members, research has shown that the presidency is determined to build on existing basic principles of the OECD on corporate governance; principles that have already informally animated the constitution of the same committee in the invitation to members to participate.

The activities of the committee (section 9—Duties of the Committee) are broad and diversified. They include the formulation of a code of ethics and the statement of the purpose and objectives. Fields of application, the materials, and actors (subjects and objects of the code of ethics) have been preliminarily defined together with the guiding principles, and the mode of assessment and verification of conditions: (1) sociopolitical ones in the countries of origin of color gemstones, (2) socioeconomic ones in the sites/countries of origin and transformation of color gemstones, and (3) of legality and transparency in the countries of the chain (producers, processors, and exporters importers). Finally, the committee shall define the detailed procedural rules for investigations of the aforementioned conditions, considering the feasibility and the operability, and the manner of presentation of the finished product to the customer.

A committee operates for three years, and its components continue to perform their functions until the appointment of the new organization (section 4); the committee members meet in an ordinary session, usually at least once a year (section 6). The president convenes and chairs the meetings, establishing the agenda on the basis of the indications of the components, and coordinates the work (section 5); the committee establishes, for each year, a report on the situation of projects carried out for the previous year, which will be presented to the board of directors of Assogemme at the final statement of the association (section 10); it deals with the association in a consistent and effective cooperation; it can request data, documents, and information related to matters of competence; and it provides information and/or projects that are useful to the bodies of the association, who have the task of formulating proposals and implement interventions related to topics and subjects including those pertaining to the same committee (section 11).

The committee is the only body at a national and international level, among recognized associations, that was set up and is working to develop innovative solutions, which are based on ethical principles, in the process of procurement and supply chain management of color gemstones. The extent and fragmentation of the supply chain, from mining areas located almost always in poor areas of the world, make difficult and complex the predefined objective. In this regard, research has shown the full awareness of the committee, in the person of its president, of developing a path of experimentation, which has no other examples. Therefore, the result of this project is not obvious, but rather it must be built in an attempt to find a satisfactory solution for all participants. The implemented process and the committee's works are already leading to redefine conditions, procedures, and working goals. The research has showed that some changes are already been made to the structure of subcommittees: the one, represented by jewelry companies, has added new members following the line of specialization, "to ensure better operational organization," while the scientific subcommittee, which already conferred more competences, has further enhanced the diversity of skills, "whose contribution in scientific research is considered a prerequisite for the implementation of the code of ethics."

In addition, there is a tendency to further enrich the team of participants for a possible enlargement of the representativeness of the committee: it is stressed the need to make contact with "the institution UNICRI (United Nations Research Institute on Crime and Justice) that is currently working on a protocol to trace the paths of gems, suspected to incite crime," and with Save the Children and the Responsible Jewellery Council.

The working groups, which are identified with the subcommittees, currently meet two specific needs for knowledge and research: the scientific committee works on the technical aspects related to the traceability of the stones, with respect to the scientific characteristics of the same; the subcommittee of jewelry companies has its objective in the identification of a traceability system that ensures the end customer in the purchase of an ethical gemstones. The attention of the latest subcommittee focuses on this stakeholder, drawing inspiration from the standard *Code of Practices* of the Responsible Jewellery Council.

Although the field of action of the two subcommittees takes its origin from different stakeholders—the first, firms extraction/mining, for studying the characteristics of the stones and then back to the origins of the same; the other, the customer, for satisfying the consumers' need for purchasing an ethical product—the integration between the two groups is strongly encouraged by the bureau of the committee. The presidents of the two subcommittees should define business ad hoc meetings, they must support the exchange of ideas, materials, and results, for which it has been created a digital platform, and they must engage in the construction of a shared dialogue.

At the moment the digital platform consist of a mailbox and a structure, established in Assogemme, which deals with the collection, management, and dissemination of all documentation (memos of meetings, working in progress) among the members of the committee. In a short term, a repository will be created that will serve as a digital archive for the collection of all documentation relating to the work of the committee, or otherwise considered useful, to which all members will be able to access, with a special password; it is also planned to create a community, within the committee, in order to facilitate the communication and the sharing of works.

The investment decisions around the implementation of this digital platform contain elements of complexity. In fact, research has found that if, on the one hand, it is manifested the need to implement these instruments, in order to make communication pervasive and flexible, and to facilitate the sharing of information among all members, also considering their different origin; on the other hand, there is the presence of a "cultural barrier," explained by the president, related to the lack of predisposition to the use of information and communication technologies (ICT) in most of the members of the Committee. Researchers, accustomed to using microscopes, entrepreneurs of handmade products and with a strong crafted content, typical of jewelry productions, but that characterizes even more jewels with colored stones, are, in the words of the president, the features that make unwilling the participants in the use of technology, hence requiring a big cultural effort.

Among the tasks of the committee have then been identified a number of new initiatives that could be implemented within the code: "actions of information given to the audience of operators, program implementation of ethical criteria for correct naming of gemological materials, dissemination of fundamentals of gemology, supervision of the sources and agencies engaged in the correct nomenclature, a brief guide to best practice in order to comply with the principles of fair disclosure, a FAQ and a phone line for answers to questions."

Multistakeholder Committee for Developing Innovative Sustainable Solutions: Managerial Implications

The experience of the Ethics Committee of the Color Gemstones is still at an early stage and it is a start-up. This fact explains the composition of the committee, which is still firmly entrenched on the representativeness of the only jewelry business, even if it is clear tendency of presidency to give the committee a heterogeneous identity, opening to the participation of members holding of different instances.

The implementation of a participatory process to achieve a goal of sustainability requires, without any doubt, an enlarged representation of different components/activities of the production chain. This representation makes it possible to meet the demands and concerns from each stage of production and distribution, and therefore to collect the specific skills related to each phase of operation and harvest the specific contribution of the different actors to the "solution" of the problem. But, above all, it makes feasible solutions proposed and gives credibility to the project. The participation of the actors in the supply chain, on the one hand, should minimize the risk of seeing thwarted the efforts made by an operator because of the unethical behavior of other actors in the supply chain, and the on other, it should maximize the impact of a sustainable project in terms of an actual effect on the whole community.

Co-sustainability involves broad participation of stakeholders, including also the institutions and the community, where the sharing of objectives and actions can really enable to implement projects with a high environmental and/or social impact, with the ultimate aim of achieving really a common good.

If the sharing of ideas, skills, and experiences occurs within a multistakeholder committee, and if this committee is credited a decision making and guiding role, then it is even more necessary to ensure a broader representation in it.

It is also important that the governance of committee should develop a governance model in line with some of OECD principles on corporate governance. With particular reference to the multistakeholder committees that are constituted within industry associations, it is believed that at least it should be insured: "Distribution of duties and responsibilities among different supervisory; regulatory and enforcement authorities; (. . .) Ensuring equitable treatment of all shareholders (. . .); Recognition of the rights of stakeholders established by law or through mutual agreements; Encouraging active co-operation between corporations and stakeholders (. . .)."[4] Many of these principles refer to a concept of *social responsibility* that should animate the behavior of the members of the multistakeholder committee. Literature has defined CSR as one of the pillars on which to build corporate governance (Ahmad and Yusuf 2005), or a model of extended corporate governance (Sacconi 2004), and vice

[4]OECD. 2004. *Principles of Corporate Governanc*e. www.oecd.org/dataoecd/32/18/31557724 *(*May 5, 2007).

versa corporate governance has been considered theory concerned with the alignment of management and shareholder interests.[5] Therefore, if the governance model, like OECD shows, covers a range of issues for the protection of the interests of shareholders and stakeholders, it embraces the principles of CSR, ergo the committee must and can operate not only in the interests of the business community but also for those of the whole community.

The multistakeholder committee, even if not established within a company but as part of an institution/association, as in the case study, must absorb these principles for being guaranteed to operate not only in the interests of the business world but also of the whole community.

From a functional point of view contamination, sharing of guiding principles, coordination of activities can be ensured by different instruments, technological and nontechnological ones, i.e., under an organizational point of view, the creation of subgroups working with specific "work packages" in which the projects can be divided assures, as also seen in the case study, the participation and the exchange.

The value of this statement founds even more confirmation if the committee's work focuses on the design of new sustainable solutions, of product or of process, without having to recall the established concepts of the richness of diversity in innovation processes, of the value of the exchange of complementary skills, and of the importance stakeholder engagement.

The outlined path for the constitution and the functioning of the multistakeholder committee does not have in itself a deterministic nature, and therefore its outcome is not obvious, but it is believed that the outlined characteristics can be considered as preconditions that can facilitate the investigation of a solution in relation to a predefined goal.

Complementary expertise in different professional fields and behaviors that are inspired by the principles of mutual respect and commitment to the project, honesty, open mindedness, and responsibility, should ensure to the multistakeholder committee to reach an objective of common interest (see Figure 12.4).

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[5]For a wide review, see: G. Aras and D. Crowther. 2009. *Global Perspectives on Corporate Governance and CSR*. Aldershot, UK: Gower Publisher.

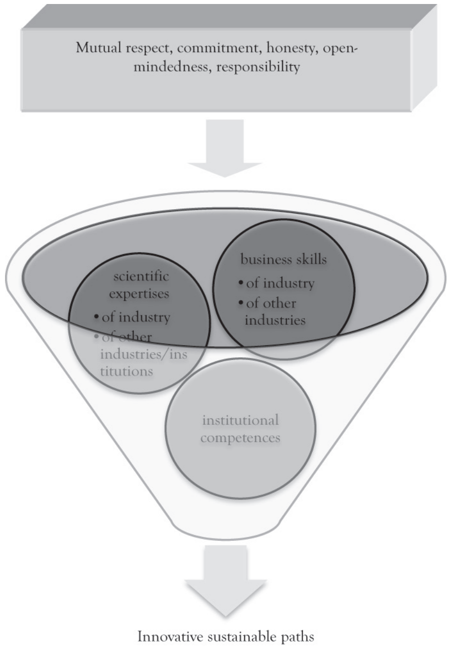

Figure 12.4 Sets of assets and principles of a multistakeholders committee

Conclusions

To have a real effect, innovative paths, which are often very complex as is the case for devising systems for traceability of precious stones and the creation of a code of ethics, must be designed within multistakeholder committees in which it is ensured a broad and representative participation of the different instances of the actors.

Innovation and sustainability appear to be two paths that are increasingly obliged to build the competitiveness of enterprises in developed countries. Strategic pathways, not only as suggested by the literature but also as evidenced by managerial practice, require collaborative models for the participation of complementary skills. The multistakeholder committee can be a container in which to realize the exchange and integration of different types of knowledge, but at the same time the representation of the different skills among the participants, it is necessary to ensure a sharing of the principles that govern individual behavior. It is believed that these principles should be guided by the concept of social responsibility and values that it supports: mutual respect, openness, honesty, trust, and commitment to society. It is therefore important that the presidency of the committee develops a model of governance that aligns the values of the various participants to share these principles, doing a periodic check of the efficiency of the model.

The experience of the Ethics Committee of the Color Gemstones is crucial because, as already mentioned, it is not only experienced in Italy, but also on an international level, which manifests the willingness of firms, even before the intervention of the legislature, to regulate the behavior of the economic actors to give rise to a sustainable supply chain for colored gemstones. Being a complex objective—as stated by its proponent, president of Assogemme—and ambitious objective—as stated by the president of the committee—it is undoubtedly to praise the interest, the willingness, and the commitment of the committee to investigate the definition of a code of ethics related to the production and marketing of colored gemstones. Finally, the author expresses a point of reflection to address the committee's work concerning the evaluation of other experiences that are taking place in other sectors,[6] such as for businesses that deal with tantalum, tin, and tungsten—mineral placed by the U.S. SEC (Securities Exchange Commission) in the list of minerals from conflict (defined *conflict mineral*)—for which these businesses are probably working on the definition of due diligence in order to ensure ethical principles in the production and marketing processes of these minerals.

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[6]An extensive review of business cases can be found on the website: http://supplychain.unglobalcompact.org/.

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Discussion Questions

1. Are there advantages in stakeholder engagement for sustainable innovation?
2. Which are the basic elements of the concept of collaborative sustainability?
3. Which are the characteristics of a multistakeholder committee?
4. Which are the tools for facilitating the integration and the participation in the issues of a multistakeholder committee?
5. Which are the characteristics of the jewelery business that justify a collaborative sustainability approach?

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Alessandra De Chiara, is an Associate Professor of Business Management at the University of Naples "L'Orientale," Italy. She is a Professor of Ethics and Market and of International Management. She received her PhD in Management in 1990/1991 at the University of Venezia, Italy. Her scientific activity is mainly dedicated to study the themes of corporate social responsibility, international processes and management of the international enterprises, stakeholder engagement, knowledge management, and social mechanism; small and medium-size enterprises, with focus on learning, innovation, and flexibility. She has written several articles in Italian and International journals, including *Journal of Small Business Management*, *Journal of Global Responsibility*, *International Journal of Technology Management*, *Journal of Business Market Management*, *Journal of Science and Technology Policy in China*. She has participated in many International Conferences.

CHAPTER 13

Understanding Ethical Governance through the Principles of Responsible Management Education—A Literary Study

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Abstract

Ethical governance is essential in today's context to make organizations responsible and promote the welfare of a wide range of stakeholders. The objective of this chapter is to analyze ethical governance through the lens of the principles of responsible management education (PRME). The chapter adopts a novel methodology of a literary study of two plays, one each from the Eastern and Western worlds. Interwoven throughout the chapter is a discussion on fostering ethical governance through the use of digital technology and social media. The chapter concludes with lessons for ethical governance based on the study.

Keywords: ethical governance; PRME; literary study; digital technology.

Introduction

Traditionally, firms have been judged on how well they serve stockholders. But in the 21st century—a new era of ecological limits, corporate ethics crises, and rising social expectations—this traditional focus offers too narrow a definition of success. Firms rely upon healthy relations with many stakeholders. This means not only creating healthy returns for shareholders, but also emphasizing good jobs for employees, a clean environment, and responsible relations with the community and reliable products for consumers (Kelly 2006). Ethical governance plays an important role in ensuring that firms and organizations fulfill the needs of a variety of stakeholders.

The objective of this chapter is to understand ethical governance through the lens of the "principles of responsible management education" (PRME). This objective is achieved through a novel methodology of study of drama literature, with a focus on governance from the Eastern and Western worlds.

This chapter is structured as follows—after a brief review of research in the area, it briefly describes the plays used for analysis in this study. The chapter then attempts to use the PRME to study ethical governance using drama literature. The chapter also relates the issues studied to the use of digital technology and social media in fostering ethical governance. The chapter rounds off with the important lessons for ethical governance based on the study.

Ethical Governance—A Brief Review of Research

Research on ethical governance has attracted the attention of scholars across the world. Menzel (2005) points out that research on ethics and integrity in governance has grown from a cottage industry into a robust and flourishing enterprise in the United States and abroad. The increasing levels of research point out to the importance being attributed to ethical governance in the current times. The growing relevance of ethical governance can also be observed from the manifold initiatives that are being launched to promote ethical governance across the world (Blume 2012). One of the international initiatives to promote ethical governance is the

PRME. The PRME is a United Nations-supported initiative to promote and inspire responsible management education and research in academic institutions around the globe (Waddock, et al. 2010). The six principles of PRME are as follows:

- purpose,
- values,
- method,
- research,
- partnership, and
- dialogue.

Researchers have used the principles of PRME to analyze the different dimensions of ethical governance. The principles of purpose, values, method, and partnership are an integral part of research literature reviewed in this section. Scholars have debated the purpose and necessity of ethical governance in organizations (Driscoll 2001; Lawton and Macaulay 2004; Wei 2005). The need of ethical governance is based on the legitimacy theory. Legitimacy theory implies that organizations continually seek to ensure that their activities are acceptable to the society. It might be self-destructive for enterprises in the long run if they ignore societal problems. Therefore, it is important that organizations are committed to fulfilling their legal responsibilities and ethical or moral obligations at the level of society (Kabir 2011). Putrevu et al. (2012) argue for the need for ethical governance because companies are under increasing pressure from multiple stakeholders to be socially and environmentally responsible as highlighted by the recent global financial crisis.

Ethical governance inculcates several values in organizations. Good governance promotes fairness and transparency (Agatiello 2008; Driscoll 2001; Llopis et al. 2007; Wei 2005). According to Van Tonder (2006), adoption of an ethical framework would significantly mitigate the implicit risk of change practices and reduce the negative consequences of change initiatives.

Research has also focused on the method and partnership aspects of ethical governance (Font et al. 2012; Kabir 2011; Kim et al. 2013). Ethical governance can be fostered by the use of social media microblogging tools like Twitter, which allows for continuous and transparent communication (Ebner et al. 2010). Caldwell et al. (2006) note that ethical governance will foster partnership with a broad range of stakeholders ensuring commitment to the long-term welfare. Ethical governance will play a complementary role for rigid governance structures, which can help foster ethical consciousness of self-surveillance and restraining moral degeneration (Bo 2007).

The research reviewed in this section shows the utility and importance of analyzing ethical governance with reference to the PRME, which is the primary focus of this chapter.

A Brief Introduction to *Mudrarakshasa* and the "Merchant of Venice"

The principles of management and governance have been effectively taught and understood through literature by several scholars (Herman 2004; Olivier 2013). Scholars have used stories and incidents from literature with great success to analyze, train, and coach executives and administrators in issues related to ethics and governance (Augustine and Adelman 1999; McCoy 1996; Whitney and Packer 2002).

The *Mudrarakshasa* is a Sanskrit play of the 4th Century AD. Authored by Vishakhadatta, the play revolves around the politics, governance, and masterly statecraft of the historical character Chanakya (Dhruva 1923). By his great learning, Chanakya had earned the distinguishing epithets of *Buddha* and *Sarvajna* (meaning highly intelligent). He was the *guru* or preceptor of Chandragupta who was a very promising prince endowed with many good qualities of the head and the heart. It was to train him up in politics that Chanakya wrote the *Arthasastra* (science of political economy). The play *Mudrarakshasa* deals around the plots of Chanakya, in ensuring that his royal disciple Chandragupta gets back the assistance and help of estranged erstwhile minister Rakshasa. The play is remarkable for its unity of action. Weber (1835) observes that it may be difficult in the whole range or dramatic literature to find a more successful illustration of the rule of unity of action. According to Indian works on poetics, the central feeling that runs through the play is that of resoluteness and determination (Dhruva 1923).

The *Merchant of Venice* is a play by William Shakespeare, believed to have been written between 1596 and 1598. The play is perhaps most remembered for its dramatic scenes, and is best known for Shylock, the moneylender, and Portia's speech about "the quality of mercy." The title character is the merchant Antonio, whose bond of a "pound of flesh," Shylock wants to execute. Portia defeats Shylock through tactful arguments in relation to execution of the bond (Dobson and Wells 2001). According to Tricker (2000), the earliest references to corporate governance in terms of executing contracts and issues of corporate identity can be found in the play.

The further sections of this chapter would study each of the principles of the PRME in relation to ethical governance substantiated from the two plays selected for the study. Also interwoven throughout the chapter is a discussion on fostering ethical governance through the use of digital technology and social media.

Purpose and Ethical Governance

The first principle of PRME deals with purpose that states, "we will develop the capabilities of students to be future generators of sustainable value for business and society at large and to work for an inclusive and sustainable global economy." Purpose is at the core of ethical governance. Kim et al. (2013) explain that social responsibility issues underlying ethical governance in the present times face different motivational factors, value systems, and commitments to different agendas internationally. Without proper purpose, ethical governance would face problems of justification.

The *Mudrarakshasa* explained the importance of purpose in governance, in the following words: "the creeper of the policy of Chanakya that is being watered with the water of the stream of intellect by means of water pots of favorable time and place, is about to bear precious fruit in the shape of the realization of the object" (Act V). The play emphasized the creation of a state that promotes welfare of all stakeholders. Kangle (1965) states, "the duty of the ruler in Arthashastra is expressed in terms of *Yoga-Kshema* (welfare). This implies something more than the mere protection of person and property; in fact *Yoga-Kshema* implies the idea of welfare, well being, including the idea of happiness, prosperity and so on." Chunder (1970) opines that "by any definition the state created by Chanakya was a welfare state par excellence in which the King was a model of personal purity and sobriety and is called upon to work for the happiness of the people." The King according to Chanakya was a constitutionalist who promoted the people's welfare at all times, in all places, and at all costs (Dikshitar 1993).

The *Merchant of Venice*, on the other hand, explained the purpose of every institution through the famous words of Antonio "I hold the world but as the world, Gratiano; A stage where every man must play a part" (Act I). The importance of an ethical purpose in governance is also highlighted in the following dialogue (Act I):

"The devil can cite Scripture for his purpose.
An evil soul producing holy witness
Is like a villain with a smiling cheek,
A goodly apple rotten at the heart:
O, what a goodly outside falsehood hath!"

Without an ethical purpose, governance structures would function like a good looking apple with a rotten heart. The *Economist* pointed out to this issue with regard to the infamous London Interbank Offer Rate (LIBOR) fixing scam of 2012 entitling it as "The rotten heart of finance" (Dooley 2012). The scam exposed the condition in which reputed banks with well-organized governance structures participated in a shameful exercise of artificially fixing the most important interest rate of all—LIBOR. This was because well oiled governance structures did not have an ethical purpose at their core. They were all meant to pursue a very narrow short sighted goal of maximizing shareholder value.

Ethical governance can be promoted through purposive people movements. Examples of those that effectively used digital technology and social media tools are the Occupy Wall Street movement (OWS) and Wikileaks. Each of these has a clear purpose. The OWS has stated its purpose as "Occupy Wall Street is a leaderless resistance movement with people of many colors, genders and political persuasions. The one thing we all have in common is that 'We are the 99% that will no longer tolerate the greed and corruption of the 1%'" (Van Gelder 2011). Similarly, Wikileaks has the mission "to bring important news and information to the public . . . One of our most important activities is to publish original source material alongside our news stories so readers and historians alike can see evidence of the truth" (Sifry 2011).

Values and Ethical Governance

The second principle of values states "we will incorporate into our academic activities and curricula the values of global social responsibility as portrayed in international initiatives such as the United Nations Global Compact." Ethical governance promotes the values of fairness and transparency (Wei 2005).

The most important value emphasized in the *Merchant of Venice* is mercy or compassion. The following lines of Portia highlight this (Act IV):

"The quality of mercy is not strain'd,
It droppeth as the gentle rain from heaven
Upon the place beneath: it is twice blest;
It blesseth him that gives and him that takes:
'Tis mightiest in the mightiest: it becomes
The throned monarch better than his crown;
His sceptre shows the force of temporal power,
The attribute to awe and majesty,
Wherein doth sit the dread and fear of kings;
But mercy is above this sceptred sway;
It is enthroned in the hearts of kings,
It is an attribute to God himself;
And earthly power doth then show likest God's"

According to Shakespeare, mercy is the basis of all forms governance as it is enthroned in the heart of kings. Governance based on compassion makes the monarch even better than the crown.

Mudrarakshasa stressed the balance of competence and character as the foundation to ethical governance. The following lines narrated by Chanakya explain this:

> What is the good of having staff full of devotion but wanting in intelligence and void of valor? Of what use, too, is a person endowed

> with intelligence, and valor, but void of devotion? Those only who combine in them the qualities of intelligence, valor and devotion, contributing to greatness, are (true) employees of the king (Act I).

The values of concern and competence as emphasized in the selected plays are also the foundations ethical governance. These values promote governance with a compassionate face supporting the welfare of several stakeholders. This is witnessed in the governance of the Tata group, an Indian transnational conglomerate as explained in the words of Ratan Tata, its former CEO,

> I do believe that we in the group have held a view and held a sense of purpose that our companies are not in existence just to run our business and to make profit and that we are responsible and good corporate citizens over and above our normal operations. By that, I mean that we play a part in the community and we shoulder community responsibility as part of social responsibility of our nation. And these responsibilities are not to be confused with employee welfare, but they go beyond our own employees and in fact concentrate on the contribution to the community and to the nation (Sivakumar 2008).

The use of digital technologies in the government machinery can similarly foster ethical values. Stahl (2005), in this regard, states that e-governance through its advantages of cost savings and efficiency can seen as an aspect of liberty, and that democratic states are supposed to provide their citizens with. With regard to the values fostered by the OWS movement, Blume (2012) notes that the movement has exploited technology in the name of justice and accountability not for personal profit or gains. Throughout the OWS movement, harnessing the power of emerging information technology has been considered to be one of the best means of creating a more just society.

Method and Ethical Governance

PRME's third principle is method. It states "we will create educational frameworks, materials, processes and environments that enable effective learning experiences for responsible leadership." According to Hoffman (1986), "a major reason why we have witnessed outbreaks of corporate wrongdoing recently as well as in the past, is not that people are less ethical than others, but rather business gives so little thought to developing a moral corporate culture within which individual can act ethically." Ethical governance requires a methodology of creating an organization culture that promotes ethical behavior. Both the plays analyzed in this chapter explain the basic principles of creating a governance culture that promotes ethics.

The *Mudrarakshasa* gave the following methods to establish an ethical governance structure (Dhruva 1923):

- the leader of the organization (King) must be the fountainhead for practice of values. The play emphasized ethical leadership by crowning Chandragupta, a person of humility and good character as the king of the country.
- the administrators of various functions must be selected based not only on their competence, but also on their character to adhere to the value systems of the organization. The play stressed the need of good administrators to the extent it states, "when the king acts improperly, it is certainly due to fault of the minister, just like an elephant becomes vicious because of the thoughtless actions of its driver" (Act III).
- Institutionalizing reward and punishment systems that promote ethical behavior: In this context, the play explains through the words of Chanakya how administrators named Bhadrabhata and Purudatta were removed from their offices because of their greed and ill habits.

The *Merchant of Venice* too provided guidelines to institutionalize ethical governance through the following guidelines:

- the leader must always uphold the course of ethical procedures and justice. Antonio in this regard exclaims in the play, "the duke cannot deny the course of law: For the commodity that strangers have with us in Venice, if it be denied, will much impeach the justice of his state" (Act III).
- the administrative machinery must ensure that they follow by action their words. Shakespeare emphasizes this trait through

the words of Portia and Nerissa: "Good sentences and well pronounced. They would be better, if well followed" (Act I).
- It is necessary to set appropriate precedents for later times. As Portia cautions the state in case Antonio is forced to give his pound of flesh, "there is no power in Venice can alter a decree established: 'Twill be recorded for a precedent, and many an error by the same example will rush into the state: it cannot be" (Act IV).
- the dictates of the conscience must be followed to ensure ethical behavior. In the play, Launcelot gives a long monolog regarding the importance of following the conscience. Shakespeare in this regard remarks, "conscience you counsel well" (Act II).

Digital technology provides a unique method to harness the power of the public toward ethical governance. Throughout the OWS movement, Twitter was used as a means of communication to instantly inform others as the events took place. Events were live streamed on Twitter, which made the police and other regulatory authorities careful about their behavior (Blume 2012).

Research and Ethical Governance

PRME gives prime importance to research and states in this context, "we will engage in conceptual and empirical research that advances our understanding about the role, dynamics, and impact of corporations in the creation of sustainable social, environmental and economic value." Research is important for ethical governance, because it ensures that governance would be based on proper logical ethical principles that can direct the actions and behaviors of the organization.

The *Merchant of Venice* explained the concept of research through two events. First, the play introduces the use of research through the process of credit rating. The words of Shylock describe the process of research in credit rating.

> Antonio is a good man. My meaning in saying he is a good man is to have you understand me that he is sufficient. Yet his means

> are in supposition: he hath an argosy bound to Tripolis, another to the Indies; I understand moreover, upon the Rialto, he hath a third at Mexico, a fourth for England, and other ventures he hath, squandered abroad. The man is, notwithstanding, sufficient. Three thousand ducats; I think I may take his bond (Act I).

The second incident in the play involves research in taking ethical decisions. As per the story, Portia is not supposed to marry a man of her own choosing as per her father's will. Instead, she must accept the one who chooses rightly from among three chests of gold, silver, and lead. The play thus emphasizes on making right decisions through proper research.

Mudrarakshasa too stressed the need of research for ethical governance. Ethical governance depends on transparency of information. In this context, the play states "concealment of facts is criminal" (Act I) as it would hamper proper research. Chanakya does sufficient research before every action. The play exclaims "Chanakya does nothing without any reason even in sleep" (Act III). This is illustrated in the way Chanakya had studied the habits of each of the administrators and had taken appropriate action to discipline them.

Digital technology, according to Prensky (2009), makes decision makers digitally wise. It not only enhances the ability of people to access data, but also improves their ability to conduct deeper analyses. Because of technology, wisdom seekers benefit from unprecedented, instant access to ongoing worldwide discussions, all of recorded history, everything ever written, massive libraries of case studies and collected data, and highly realistic simulated experiences equivalent to years or even centuries of actual experience. This helps to find practical, creative, contextually appropriate, and emotionally satisfying solutions to complicated human problems.

Partnership and Ethical Governance

The fifth principle of PRME is partnership that states "we will interact with managers of business corporations to extend our knowledge of their challenges in meeting social and environmental responsibilities and to explore jointly effective approaches to meeting these challenges."

Mudrarakshasa emphasized on partnerships to create ethical governance structures. Chanakya states in the play, "authors of works on politics speak of three forms of government, namely ruled by the king i.e. autocratic, that administered by the minister i.e. ministerial and that conducted by them both jointly" (Act III). By acknowledging the joint governance methodology, the play explained the importance of partnership in governance. It is in this context the play points out, "an obstinate minister, partnering with a king possessed of heroic qualities, is sure to win fame. But by partnering with a bad king, even an unerring minister falls, with the fall of king" (Act VII).

The *Merchant of Venice* is full of partnerships at work. While Antonio and Bassanio are always together, so are Portia and Nerissa. This efficient partnership helped in establishing the rule of law and fairness easily.

Shaw and Shaw (2010) state, "a key prerequisite of ethical behavior in business is to seek compatibility with the public interest. Protection of the public interest lies in a firm commitment to the ideological conception of the rule of law complimented by international human rights standards in order to address corporate corruption." The Johnson and Johnson credo (Cavallo and Brienza 2006) explains the idea of partnership in ethical governance:

> We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality . . . Our suppliers and distributors must have an opportunity to make a fair profit. We are responsible to our employees, the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. We must provide competent management, and their actions must be just and ethical. We are responsible to the communities in which we live and work and to the world community as well. We must be good citizens—support good works and charities and bear our fair share of taxes . . . protecting the environment and natural resources. Our final responsibility is to our stockholders. Business must make a sound profit.

The principle of partnership in ethical governance has in many instances made the state generate helpful mechanisms and policies to incubate corporate and public sector innovation and support infrastructures. For example, there was a change of government in India in June 2014. The new Indian government is planning to bring about a complete transformation of the health sector and is working on the blueprint of the world's largest universal health insurance program (Firstpost 2014). In Norway, the government efforts to facilitate innovation in the tourism sector include financial supports, consultancy services, skills development programs, and R&D schemes (Mei et al. 2013).

Dialogue and Ethical Governance

The final principle of PRME states, "we will facilitate and support dialog and debate among educators, students, business, government, consumers, media, civil society organizations and other interested groups and stakeholders on critical issues related to global social responsibility and sustainability."

The *Merchant of Venice* stressed the need of dialogue for ethical governance. While the dialogue between Shylock and Antonio led to the prejudiced contract, it was the dialogue between Portia and Shylock that led to the establishment of justice. In fact, Portia pleads for a just end to the contract when she exclaims, "Be merciful: Take thrice thy money; bid me tear the bond" (Act IV). She also cautions Shylock in case of any injury to her client, "Have by some surgeon, Shylock, on your charge, to stop his wounds, lest he do bleed to death" (Act IV).

The *Mudrarakshasa* explained the importance of ethical dialogue in governance. In the play, Chanakya regularly finds out whether the citizens are happy with Chandragupta's rule. He asks an administrator, "do the subjects love the king?" for which he gets the reply, "the subjects ardently love His Majesty Chandragupta" (Act I). This regular dialogue and feedback helped the administration to work for the welfare of the society.

The dialogue principle of PRME helps governance to understand the needs of the stakeholders and work toward them. The vision statement of Excel Industries, an agro-chemicals corporate based in India, exemplifies this:

> We dedicate ourselves to make humble contributions to the country, industry, rural society and our company through technology, innovation and through individual and collective endeavor.

> Satisfaction of our shareholders, customers, our own people, suppliers, institutions, investors, society and community is paramount to us. We will make wholehearted efforts for the fulfillment of this objective through our interactions and interdependence with them. We have a responsibility towards industry and community. Rural community is the heart of India. We will be friends and contributors to well-being of both the industrial and rural community. Not only through our products and services, but also through our knowledge and expertise, we will be of assistance to community and industry. We will work and contribute, learn and grow together in the spirit of "*Saha Viryam*" (unity and balance) (Sivakumar 2009).

According to White (2013), there is little doubt that the Internet, through its networked and mobile functions, has changed the way that people find information and the way have dialogue among themselves. Digital technologies have made people stay connected and protest together in interesting ways, thus fostering ethical governance in corporations. McCarthy (2012) reported the contents of e-mails that proved the corruption and fraud practiced by Bank of America, which profited at the expense of their own clients. The OWS movement used specific blogs and Twitter hashtags to help organize and spread information about these corrupt and fraudulent practices among the public effectively (Blume 2012). This has led to heightened dialogue among enlightened public regarding corporate malpractices, which can ensure ethical governance.

Conclusion—Lessons in Ethical Governance

This chapter dealt with understanding ethical governance through the lens of PRME. The various lessons for effective ethical governance as gleaned from the plays analyzed in this chapter are summarized as conclusions:

- Ethical governance in order to be sustainable must be founded on a philosophy of welfare. It should take into account the needs of various stakeholders and work toward their welfare.
- The value of concern for others is essential for ethical governance. This will promote governance with a compassionate face.

- To be effective, it is vital to promote a culture, which promotes ethical behavior among all the members involved in governance.
- Promoting conscience-based decision-making in organizations would go a long way in promoting ethical governance.
- Ethical governance should be based on the principle of transparency of information. Research efforts must be aimed at achieving transparency.
- Creating effective partnerships between organizations and stakeholders and involving in constant dialogue with them is of utmost importance to ethical governance.
- Digital technology and social media vehicles should be effectively used to foster ethical governance.

The lessons for ethical governance outlined in this chapter can go great lengths in making governance structures more responsible and work toward promoting the welfare of a wide range of stakeholders.

Dedication: The author humbly dedicates the paper to Bhagavan Sri Sathya Sai Baba, the Revered Founder Chancellor of Sri Sathya Sai Institute of Higher Learning, Prasanthinilayam, India.

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Discussion Questions

1. What are the advantages of using digital technologies and social media in fostering ethical governance?
2. Can ethical governance be a panacea to all the problems of the current times?
3. How can corporations accommodate the competing needs of different stakeholders in an amicable manner? Can ethical governance play a proactive role in this regard?
4. How can conscience-based decision making be institutionalized in corporations?
5. How does PRME help in creating the next generation of responsible managers and leaders? What changes are required in current management thinking to make business more responsible?

Key Terms

Corporate governance: The system of rules, practices, and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders in a company—these include its shareholders, management, customers, suppliers, financiers, government, and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

PRME: The PRME is a United Nations-supported initiative to promote and inspire responsible management education and research in academic institutions around the globe.

Ethics: The basic concepts and fundamental principles of decent human conduct. It includes study of universal values such as the essential equality of all men and women, human or natural rights, obedience to the law of land, and concern for health and safety and, increasingly, also for the natural environment.

Stakeholder: A person, group, or organization that has interest or concern in an organization. Stakeholders can affect or be affected by the organization's actions, objectives, and policies. Some examples of key stakeholders are creditors, directors, employees, government (and its agencies), owners (shareholders), suppliers, unions, and the community from which the business draws its resources.

Corporate culture: The beliefs and behaviors that determine how a company's employees and management interact and handle outside business transactions.

Credit rating: An estimate of the ability of a person or an organization to fulfill their financial commitments, based on previous dealings.

Legitimacy theory: Legitimacy theory posits that businesses are bound by the social contract in which the firms agree to perform various socially desired actions in return for approval of its objectives and other rewards, and this ultimately guarantees its continued existence.

Global financial crisis: Many economists consider the financial crisis of 2007–2008, also known as the Global Financial Crisis and 2008 financial crisis, the worst financial crisis since the Great Depression of the 1930s. It resulted in the threat of total collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world.

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CHAPTER 14

Postscript: Board Dynamics, Market Turbulence, Knowledge Asymmetries, and Long-term Structural Relationships

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Time Horizons, Issues of Diversity, and Sunk Costs

Abstract

In this chapter, the editors seek to provide some ideas about the diversity and range of options for development and change as well as an insight into the challenges posed in the evolving global business and governance

environment. The longer-term future is not fixed nor are current structural relationships stable in the medium to long term. The latter changeability applies whether we are analyzing potential for social, political or economic change, or considering change potential in environmental terms. The future of the world is evolving in a dynamically complex manner and will be determined by the fluid interactions within the various fields of endeavor of humanity. There will thus be some areas that will be amplifying the trending forces operating today. Yet others, where the prevailing resources, focus, capabilities, will-to-change or energy of the relevant socio-political, cultural and economic force fields will be dissipating as new alliances emerge or old ones dissolve and governance is made more or less secure as a consequence. Nonetheless, the currently-perceived trending force fields, focus and direction for corporate and collective governance in the public and private sector institutions and agencies is towards greater transparency and ethical integrity although that road is a thorny and stony one indeed.

Keywords: Force fields, Emergence, alliances, focus, capabilities, will-to-change.

The array of chapters presented in this book has covered all of the aforementioned topics in the current postscript chapter title. The future balance sheets of businesses and governments are inevitably opaque: the future is emergent, the past is not a consistently reliable guide to the balance of forces driving new dynamics facing leaders and boards. The chapters in this book strongly suggest that the nations and people of the world are searching for new, better forms of governance at individual, firm, and national and global levels. The negative impacts of cycles of poor governance and excessive wealth concentrations in particular stakeholders, whether at firm level or at the level of government, serve to induce dispirited populations of workers and citizens with reduced trust in public or private entities. There may not be a "one-size-fits-all" method to resolve the diverse issues of governance at local, regional, national, and international levels.

Hence, we have presented a menu of potential scenarios and from a range of nations as well as types of organizations. We have discussed the topical concerns and reflected upon the focused long-term investments required in capabilities of people, technology, and in the popular will to change from "business as usual." This includes changed orientations to what constitutes good governance for both business enterprises and countries.

Governance of sunk costs of 30-, 40-, or 50-year investment projects are already well recognized as being vital in many industries such as resource mining and oil or gas extraction, refinement, and distribution, not only to sustain the current processes but also to transition to less environmentally damaging systems. Even in industries where a shorter time horizon might be expected, such as many fast-changing, innovative technology sectors, the need to use a longer time horizon for investing in sustainable futures is evident though risky. Equally, pharmaceuticals make large long-term R&D investments and governments make investments in national infrastructures where the "payback period" extends beyond the term of any elected party.

Some of the well-known systems for creative thinking around planning for the ambiguities of such an opaque long-term future were originally developed in these same sectors, e.g., Shell's scenario planning originally devised by Pierre Wack (McKie and Cockburn 2000). Nevertheless, to adapt Heskett's question (2001, 2) quoted in Chapter 1, even if the financial auditing reveals all is functioning efficiently in terms of cost control, revenue generation, and so on, is it also functioning effectively as "future-proofing" us for what we already know is looming in the long term? Table 2.1 in Chapter 2 illustrates this with regard to innovation, but the same concepts may be applied to governance in general. That is the "known" issues governance must address. Aside from the known, there are the known "unknowns" for which we have some solutions with which to react and respond. Then there are "random, chaotic factors" that are insufficiently predictable or novel, unknowable issues: the "unknown unknowns."

Currently, there are a critical number of such "known unknowns", i.e., problems we are aware of currently such as climate change, which have proposed solutions that are not agreed globally or even locally in many instances. Other such known unknowns or governance issues that remain unresolved including the agreement on a definitive answer to the question of "what is global or regional best practice in Enforcement of good governance?" The hastily drafted 2002 U.S. Sarbanes-Oxley regime has proved less effective in curbing problems of governance in advanced economies than originally expected. The less hastily drafted EU Action Plan laid out in the 2003 draft from the European Commission on "Modernising Company Law and Enhancing Corporate Governance in the European Union" envisaged four main pillars for corporate governance reform:

1. enhancing corporate governance disclosure/reducing information asymmetries;
2. strengthening shareholders' rights;
3. increasing the role of nonexecutive directors; and
4. coordinating corporate governance efforts of member state.

There is little doubt that these are all worthy in many respects. However, the effectiveness of EU regulations has also been questioned since there still remains considerable variation of focus in the regulatory regime as applied in different countries. Thus, there may be appropriate focus and even governance capability available, but there seems a lack of will to act among leaders.

When looking beyond the EU, these kinds of regulatory measures are premised upon a sophisticated board process and Western-type structures, which are less common in many regions such as Africa.

> One of the challenges facing modern corporations in Nigeria may stem from lack of qualifications of corporate board members. According to the Central Bank of Nigeria (2006), many board members may lack the requisite skills and competencies to effectively contribute to leadership of modern corporations.
>
> (Okpara 2011, 188)

The functioning of internal Corporate Governance mechanisms and stakeholders' roles is still an under-researched area within emerging markets as noted by Ararat et al. (2014, 19). In Chapter 5, by Pomare and Berry on Canadian Higher Education governance, they discuss the gap between internal and external strategic environments and perceived scenarios of staff as stakeholders. Ogunyemi and Nwosu, also comment in Chapter 6, on the need for further development of academic and professional conversations around the character and scope of the internal "organizational footprint" of governance in stakeholder theory. Thus, there are still many matters concerning processes for empowerment, innovation, trust building, and collective capability to be resolved.

The Role of the State

Oberoi (2014) also comments in Chapter 3 "The quality of public governance impinges on the level of law enforcement and extent of corruption." The nature, role, and functioning of state governance as a scene setting or contextual actor has been questioned in many areas in the EU and beyond as Mickelthwait and Wooldridge remark (2014):

> In Brazil and Turkey in recent years, huge numbers of protesters have marched in the streets against the corruption and incompetence of their rulers. In Italy, since 2011, three prime ministers have found themselves defenestrated, and in last year's national elections, voters awarded the largest share of votes to a party led by a former comedian. In May's elections for the European Parliament, millions of British, Dutch, and French voters, frustrated with their countries' political elites, chose to support right-wing nationalist parties—just as legions of Indian voters turned to Narendra Modi during elections this past spring. In November, Americans will trudge to the polls more full of anger than hope.
>
> (Micklethwait and Wooldridge 2014, 1)

Often, as Shirky (2011) has indicated, such activism arises from surprising sources and is spread in viral fashion via social media conversations.

Potentially disruptive combinations of transdisciplinary, sociodigital technologies, cross-over applications, products, and processes alongside social media are critical to governance nowadays (Smith and Cockburn 2013, 2014). Chapter authors have argued that new sociodigital media not only have the capability to increase the speed of communication and the connectivity between many actors but also, by effectively bypassing many official gatekeepers, often encourage change by providing a voice to alternative views and debates, thereby increasing the dynamics of communication for social and political activism.

Governance Innovation and Dynamic Digital Technologies

There are some clear trends broadly agreed by most mainstream commentators. That is, a shift toward ensuring more transparency and greater voice for diverse communities of stakeholders as well as shareholders or owners. As the World Economic Forum (WEF) states:

> Today, digital technologies play an increasingly important role in the daily lives of people and businesses, altering attitudes towards the nature, delivery and providers of public services. Citizens expect to have fast, easy, safe and accurate access anywhere, anytime. The technology that empowers citizens offers ways for governments to improve service design and delivery. They include: open data and big data; embedded technologies and the Internet of Things; integrated and ubiquitous mobility platforms; cloud computing; and next generation networks.
>
> (Attali, Curtin, and Jarrar, chapter III, WEF, 27)

The WEF report titled "The Future of Governance" asserts that governments as well as the world's top enterprises will need to invest long term in giving voice to the under-represented and improving the human condition and employ exponential technologies and innovation to significantly accelerate their objectives (result) (WEF 2014, 8). Views on the scope of the necessary changes to enterprise, social, and political governance and related systems obviously vary depending on what is the focus of attention at any time or what is prioritized.

Some changes are more far reaching than others and will involve everyone in some way as the basic premise is that we all inhabit the same planet and cannot avoid the collective impact of environmental degradation and climate change. Thus, corporations, governments, and NGOs ought to cooperate to mitigate or avoid a global climate catastrophe. Others such as the application of covert forms of control like algorithmic governance or regulation by smart devices have potentially dystopian implications as noted in Chapter 1(Morazov 2014).

There are some radical ideas for changes in two recent Club of Rome reports. The core data underpinning these forecast each spanning the next 40 years is from research by professor Jorgen Randers (2012), one of the original coauthors of the 1972 Club of Rome reports on "Limits to Growth" and the later sequels in 1992 and 2004. Traditionally, the Club of Rome has focused on population and climate studies and forecasts of the impact of this on regions and on the global environment. Randers suggests that support for strong state intervention is needed. He sees the West being rescued by the major power in the East, China. He states:

> I think we will see 40 years down the line that it was the Chinese who did, in the end, solve the climate problem for us—through collective action. They will produce the electric cars and the technologies we will need, and they will implement them in China through centralised decisions. Meanwhile, we will be fiddling around with half-baked quota systems that provide insufficient incentives—which might modify development somewhat, but doesn't solve the problem.
>
> (Randers 2012, 15)

He goes further to suggest that the developed nations reduce their populations to reduce consumption and fund clean energy systems for the less developed as a means of reducing climate change for all (Randers 2012, 14–15).

The impact of the changes in technology and constraints of the current global financial, commercial, and environmental systems, as described in the Club of Rome's new scenarios for 2052, are summarized as follows:

- There is a 40-year window for humanity to take actions to avoid the most serious negative consequences of our decades-long overconsumption of planetary resources. The process of adapting humanity to the planet's limitations may be too slow to stop planetary decline. Currently the human demand on the biosphere exceeds the global biocapacity by some 40 percent.

- Global population will grow, peaking at 8.1 billion people in 2042 because of rapid decline in urban fertility.
- Global GDP will grow much less than generally expected because of slow productivity growth in mature economies, and lack of takeoff in the 186 poorer countries.
- Global GDP will peak after 2052, and investment share of the GDP will grow as society is gradually forced to handle issues of depletion, pollution, biodiversity decline, climate change, and inequity, slowing growth in consumption growth with a fall in disposable income in some places.
- Global energy use will reach a peak in 2040, because of continued increase in energy efficiency.
- CO_2 emissions will peak in 2030, because of a shift toward low-carbon sources of power and heat.
- Nevertheless, CO_2 concentrations will grow, and the global average temperature will pass the danger threshold of +2 °C by 2050 peaking at 2.8 °C in 2080, which could then trigger self-reinforcing "run-away" warming (with a possible global societal collapse in the second half of the 21st century)
- The United States will experience the greatest stagnation, while the process of stagnation will occur more gradually in the other OECD countries. China, Brazil, Russia, India, South Africa, and 10 leading emerging economies will progress, but this will still leave 3 billion people in poverty.

The scenarios are not considered as inevitable. There is a margin for error since no one can predict the future with 100 percent accuracy. However, the scenario forecasts allow leaders to test their own assumptions against those of the Club of Rome's experts. Naturally, climate skeptics and others will wish to question the data, timescales, and trends underpinning the scenarios. All scenarios are as subject to error as other extrapolations from the present as we have remarked in previous chapters.

There are also some less pessimistic scenarios such as the two World Energy Council Scenarios (titled "Jazz" and "Symphony"), which envisage improved energy efficiency gains of between 30 and 50 percent compared to energy consumption in 2010. As the WEC report indicates:

> The share of renewable energy sources for electricity generation will increase from approximately 20 per cent in 2010 to more than 30% in 2050 in Jazz and nearly 50% in Symphony.
>
> The degree to which renewable energy sources will be used and investment in CC (U) S technologies for coal and gas (and also biomass) will be decisive in mitigating climate change.
>
> (WEC, p. 26)

In any case, there are clear governance implications emanating from whatever scenario is applicable at any point in time. The "Jazz" scenario involves much less regulation but more local innovation than the "Symphony" scenario, which presumes some central direction of effort. Equally, the "Jazz" scenario assumes less shared values other than transitioning to more sustainable energy futures.

Thus, we might once again posit Heskett's (2001) question referred to in Chapter 1 in the concluding section.

What Is to be Done?

The Club of Rome's answer involves some major restructuring with a focus on creating and evaluating new long-term global governance paradigms and capabilities to ensure that these changes can be made to work sustainably over time. Inevitably, there will have to be changes to social priorities and social mores to embed and encourage a long-term perspective, which may not always be palatable, viewed from our current businesses, institutional, or societal perspectives. On their webpage, under the heading "Basic Assumptions," they indicate the underpinning assumptions about constraints on progress to alleviate climate change that are used in the scenarios to 2052 as follows:

> Humanity's systems, which uphold "business-as usual" are very resilient towards real change. Rapid change does not happen until people's patience caused by the negative consequences of

> "business-as-usual" (climate change effects, inequity, resource depletion) runs out. Society's main institutions: democracy and economy are based on short-termism, resulting in a slow societal response to challenges, which need long-term solutions and investments.
>
> (Club of Rome, retrieved on January 7, 2014 from http://www.clubofrome. org/?p=703)

Obviously, the perceived causes of short termism of institutions vary according to the observer. Roe (2013, 1003) states:

> The corporation may indeed need to plan more today for the short run than for the long run. But the explanation for the shortened planning horizon may lie more in the nature of shortening technological life cycles, globalization, and changing government policy than in the financial markets external to, or the structures internal to, the large public firm.

The Club of Rome—EU branch report on monetary policy and sustainability (2012) draws other conclusions. Referring to IMF data, the authors note, ". . . between 1970 and 2010 there were 145 banking crises, 208 monetary crashes and 72 sovereign-debt crises-in other words, a staggering total of 425 systemic crises. An average of more than 10 per year! These crises have hit more than three-quarters of the 180 countries that are members of the IMF, many of them being hit several times." Aiming for sustainability and good governance at macrolevels without restructuring our money system is therefore deemed ". . . a naive approach, doomed to failure "(Club of Rome 2012, 9). The report further states that monetary instability can be solved by the creation of complementary and cooperative currency systems to operate in parallel with the conventional bank-debt financial monetary system, counterbalancing the negative effects of the conventional system while utilizing the underused local resources in communities.

Such resources they say include individuals with time and talents; and businesses, voluntary associations, and local authorities with spare capacity. They envisage this approach as a means to build civic community spirit and address growing social costs such as care of the elderly, refurbishment of communities, and environment without burdening the community with extra taxation costs.

Paraphrasing and summarizing their list of presumed advantages, we can say these include the following:

- rebuilding communities and strengthening local economies;
- helping to protect local environments;
- sharing inventory, labor, and skills within the community;
- harnessing volunteers more effectively;
- supporting learning, training, and skills sharing;
- sustain local businesses with spare capacity; and
- meeting the demand for the care and support of the elderly.

Finally, these programs are not seen as being at risk from a "meltdown" in the financial sector, help build social capital, value people, and are unlikely to produce a short-term perspective, wealth concentration, or cause "boom and bust" cycles in the economy (as it requires unending growth instead of recurrent cuts). So this approach is viewed as addressing the major problems currently experienced in a number of troubled post-Global Financial Crisis economies in the EU such as Greece, Spain, Portugal, and Italy.

There are many other such scenarios and the WEF has its own, published in 2013. Their scenarios converge in some respects and diverge from others mentioned earlier. The WEF scenarios are as follows: in the first scenario, WEF envisages a world ruled by "megacities," where governance is administered largely by major urban agglomerations. The second possibility is a world in which strong central governments use big data to fortify their control somewhat akin to the "algorithmic governance" concept referred to in Chapter 1 and earlier. In the third scenario, central governments are fundamentally weak, with markets—and the enterprises that dominate them—providing almost all services (WEF 2013). Governmental transformations envisaged include massive urbanization or mega regionalism; community building and identity; shared societal expectations; availability of financial resources for government; nongovernmental delivery of services; division of labor among actors; big data;

cyber capabilities; complexity of challenges; fads and fashions in governance models; and leadership. As Joseph Nye and others indicate in the "Future of Government Smart Toolbox" (2014, 5–7), "If well managed and strategically deployed, information and communication technology (ICT) can reshape government in the next decade by strengthening trust in government, leadership, delivery of services, political representation, anti-corruption, bureaucratic cooperation, the management of conflict, and innovation."

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Tom Cockburn obtained his first degree with honors from Leicester University, England, both his MBA and Doctorate were gained at Cardiff University, Wales. He has several professional teaching and assessment qualifications, including e-moderator certification and executive coaching qualifications from UK Universities and Professional bodies as well as from the Waikato Institute of Technology (New Zealand) and Hay Consulting (Australia). Tom is Associate Fellow of the New Zealand Institute of Management and has experience on a number of editorial boards of academic journals, and review member of the *Cutting Edge*

Awards Committee of the US Academy of HRD. He has 5 years Board experience on the Standing Conference of Welsh Management Education Centers, one year as a non-voting Trustee in K'aute Pasifika Board, New Zealand and has carried out a number of Institutional Teaching audits in the UK. Tom has 8 years senior academic experience as Head of a UK Business school and a deputy Head of School role in New Zealand as well as adjunct and visiting E-faculty roles on Henley Business School (UK) and Ulster University Business Schools' MBA and MS programs. He is currently Director, Policy, for the Center for Dynamic Leadership Models in Global Business founded in 2012. Tom is also co-author and co-editor respectively (with Peter A.C. Smith) of *Dynamic Leadership Models for Global Business: Enhancing Digitally Connected Environments* (2013) and in (2014) *Impact of Emerging Digital Technologies on Leadership in Global Business,* published by IGI Global.

Khosro S. Jahdi

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Edgar Wilson JP, has considerable experience on Trusts in a range of governance roles. These present roles include Deputy Chair and Trustee of First Credit Union with a membership of 58,000. Deputy Chair of Trust Waikato, Deputy Chair of K'aute Pasifika (a Pacific Health Provider) and elected member of Independent Tertiary Education New Zealand Board. As well a raft of leadership experience and expertise Edgar has presented at a number of conferences both national and international. The most recent being a paper presentation at the World Council of Credit Unions (Gdansk, Poland 2012) entitled: ***First Credit Union (NZ) case study: Building a culture of integrity-practical tools and techniques***. Edgar is the joint author of a chapter of a book titled ***Business Integrity in Practice: Insights from International Case Studies*** part of the *Principles of Responsible*

Management Education (PRME) United Nations book collection. One of the first books in the UN collection for the PRME series.

Study Questions

1. Would you agree with Randers' assertion about the role the Chinese government may play in the future in moving the rest of the world to more sustainable development? Give reasons for your answer.
2. How "open and transparent" can governance become without endangering commercial and/or public security and well-being? Refer to case studies where possible to illustrate your case.
3. Is social media drawing us into populist referenda on every aspect of governance in the public sphere? Would that work to enhance citizens' freedom and choice or would it reduce political action and debate to the "lowest common denominator" or result in voter apathy and thereby pose a threat to democratic advancement?

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—Oliver Laasch, University of Manchester, Collection Editor

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Responsible Governance

International Perspectives for the New Era

Tom Cockburn, Khosro S. Jahdi, Edgar G. Wilson

Evolving stories of governance and change are being written into the emerging custom and practice of all kinds of organizations today, whether they are global or domestic, startup or blue chip, corporate or government agency. Changing ways of 'doing business' are not new, nor is globalization of business, but the velocity and trajectory of both are rapidly accelerating beyond those seen in previous times.

There are increasing concerns and challenges for the boards of directors and other governance systems and processes. They are intended to ensure good stewardship of the diverse organizations in the period following the global financial crisis. Responsible Governance aims to challenge assumptions and present current debates for readers, grounding the critical issues or descriptions in relevant historical and social contexts as well as suggesting ways forward.

Dr Tom Cockburn obtained his first degree with honors from Leicester University, England, both his MBA and Doctorate were gained at Cardiff University, Wales. Tom is associate fellow of the New Zealand Institute of Management and is currently director-policy for the Center for Dynamic Leadership Models in Global Business and a senior associate of The Leadership Alliance Inc., headquartered in Canada.

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