THE IMPORTANCE OF A WELL DEFINED CORPORATE GOVERNANCE

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Abstract
Present day discussions of corporate governance are mainly centred on finance related issues, stakeholder management, and leadership. In a broader view the definition of Governance varies nowadays and is used in several meanings as e.g. corporate governance, organizational governance or business governance. The objective of the paper is to identify and discuss the key criteria to ensure a well-defined corporate governance. The methodology used involves interviews with 40 managers and company leaders from global acting medium sized manufacturing and service companies in order to gather information about the key elements of a corporate governance and the issues they are facing on an operating level with their corporate governance. The key elements are applied in a case study in order to understand which the main components to define the corporate governance are. The results show that the principles for corporate governance are the right one, the implementation, monitoring and review is more than important to have a stable and well defines corporate governance in place.

Keywords: Corporate governance, Accountability, Stakeholders, Responsibility, Medium sized companies, Ethical behavior

JEL Classification: M14

Introduction

Globalization in a broader view fundamentally changes the operating conditions especially of global acting multinational companies. Due to the increase of international trade and the foreign direct investment, the influence of transnational corporations is growing and the velocity of circulation of money is accelerating and financial markets are gaining the momentum. (Scherer, et al., 2008) As a result of these changes the corporate governance of multinational companies is getting more complex and has the need to be well defined from the financial business perspective, as of the sustainable perspective. Companies are global acting and facing complexity e.g. in terms of increasing number of stakeholders, different business cultures, diverse laws and regulations in the operating countries.

The concept of governance exists since any kind of organization exists. Of course it was not written down or used in a structured manner, but it exists since companies are operating. (Crowther D., et al. 2011) Each company needs to be successful and an understanding how they run the decision making processes within their organization.

To have a well-defined corporate governance, it is also important to take into account the organizational structure. The governance needs to implement well and supported be the organizational structure as this could be a functional, geographic, product, customer segment, channel or process based organizational structure. For each type of organizational structure the governance should work well. (Lange et al., 2016)

1. Theoretical aspects: The principles of corporate governance

The Principles of Corporate Governance are defined by the OECD. In this chapter I will explain the principles from the theoretical background of each aspect. The definition of corporate governance by ISO FDIS 26000 is the understanding by which the organizations makes decisions and implements the decision making rules, process (e.g. RACI) and committee structures. To ensure that an organization is well performing it need an implemented corporate governance. (Crowther D., et al. 2011)

I. Right and equitable treatment of Stakeholder

The importance is that the stakeholders feel involved. No-one along the governance process should feel excluded as this could cause problems at the interfaces along the governance process and in addition could cause deep content based discussions and rise corporate culture issues. An organization should also respect the rights of the stakeholders. This can be supported by an open an effective information and communication cultural. Along the process to treat shareholders appropriate, effectiveness is relevant too. Effectiveness is the ratio of the achievement of the planed purpose or milestones. Thus for effectiveness it's necessary that the processes work well along the planed content, interrelations, interfaces, responsibilities and timeframe. The resources must be used as well in a sustainable way that the efficiency continues along the planed timeframe. Furthermore, from a sustainable perspective the stakeholders have an interest in the development of the organization possibly down to an activity level. In some cases stakeholders want to shape the activities, but this depends on the rights and level of influence of the stakeholder. (OECD 2015)

II. Interest and accountability of other Stakeholders

Organizations needs to recognize that they have legal, social and market driven obligations to stakeholders, e.g. employees, investors, creditors, suppliers, regional communities or network, customers and government bodies. Interest of other stakeholder needs to be reflected or designed as well from the perspective of accountability in the context that actions taken by the organizational stakeholders effects the external environment. (Clarke T., 2007) Therefore needs to be clear responsibilities in place to know who the owner of the task and activity is. Furthermore to know who is the decision maker on that and who is performing this activity. This should be performed also in a sustainable form. Which implies that the responsible person which acts should however not use more resources to perform than can be regenerated. (Aras & Crowther, 2007) According to ISO 26000, accountability is the state of being answerable for decisions and activities to the organizational governing bodies, legal authorities and other stakeholder. To be accountable means to be able to proof anytime for what you are responsible for. The company is not isolated from the external network and this is also proofed by the accountability to take ownership for specific activities. Taking accountability does also mean to reflect the impact of the activities and if the result is negative to be able and agile to not repeat a negative activity in a broader view. (Jones C., Hesterly W.S. & Borgatti, 1997)

III. Role and responsibility of the board

The board of management needs relevant skills and understanding to review and steer management performance. It also needs effective size on an appropriate level of independence and deep commitment to the organization and decision making process. Participation is a need to get the rule of law and other principles implemented and used. The stakeholders involved should participate and work well within the defined governance structure. For that reason participation is an essential principle. Depending on the size and structure of the organization participation can be either direct or through legitimate intermediate institutions, for example in the case of a national government or parliament. (OECD 2015) Responsiveness follows aligned in the logical structure of Rule of Law and Transparency. That means that the people of the board are aware of their role and responsibility within an end-to-end governance process to get the process implemented and working within the committed timeline and milestones along the process.

IV. Integrity and Ethical Behavior

Integrity as a fundamental requirement for board members and key decision makers. In organizations there should be a code of conduct accessible for any stakeholders, which are designed for their directors and executives. This enables integrity by written consent and agreement and supports an ethical mindset and a responsible decision making. This follows logically the transparency principle. These rules must be enforced impartially without misusing power of relationships. To be clearer, this mean e.g. rights of minorities needs to be respected anyway and without compromise. To secure this an independent party of conflict resolution (might be a role or a committee). (OECD 2015) Not all the regulations in force are needed to define a good governance, this is always to be seen in the context of the specific organization, the sector where the organization is operating and the geographical aspect e.g. country specifics and regulations (e.g. related to religions, power concerns, culture).

V. Disclosure and Transparency

Disclose refers to the access to important information for the defined group of stakeholders which required these information and reports. Transparency is a key principle that all information in the content of the business and roles is accessible, available and updated. Furthermore the decisions which the Stakeholder will take must follow over all rules or so named corporate guidance. This needs to be reflected as open source and needs to be compliant. Transparency on the other hand doesn’t mean to reveal proprietary information – this would cause conflict of interest for the organization. (OECD 2015) For example privileged information which is sensitive from a data security, commercial, legal and personal point of view should not be assessable or only assemble to a well-defined focus group.

2. Research methodology used for assessment of organizational governance structure in medium sized companies

From October 2016 until January 2017 we have conducted 40 interviews in global acting medium sized manufacturing and service companies with a structured questionnaire on the topic of corporate governance to figure out the what works well and also the concern and issues to get a conclusion what would be necessary to well defined corporate governance in place. Four questions to rate from 1 (excellent) to 5 (low) these questions which reflects on one of the principles. Furthermore there were two open question asked. The interviewees came up with interesting answers, which can used as a trend and should be more evaluated in the future on these outcomes.

Based on the company profile we drew a governance pyramid as an easy understandable example how in a company the corporate governance structure could look alike. In that case it's an example of a multinational service company. All is starting with the Vision, Mission Statement and the Strategy of a company. After that there are typically three layers where you can point out the level of accountability and decision making in an organization. The first layer is about diving Direction: That means key processes, focus of the organization and steering is structured on that layer. The second layer is about operations and organization. On that level is the operating model defined and the overall way of working within the organizational and there interfaces. (De Vries M., et.al. 2011) The third level is about people, processes and structures. After the definition of the operating model it is necessary to define in detail the processes within the model and the structure, the functional model of a company. In the figure there are highlighted some key elements which have only the character as an example. The fundament, let's say the baseline is the internal audit model which is presented as the authority board to prove that the organization is operating along there governance principles.

3. Results

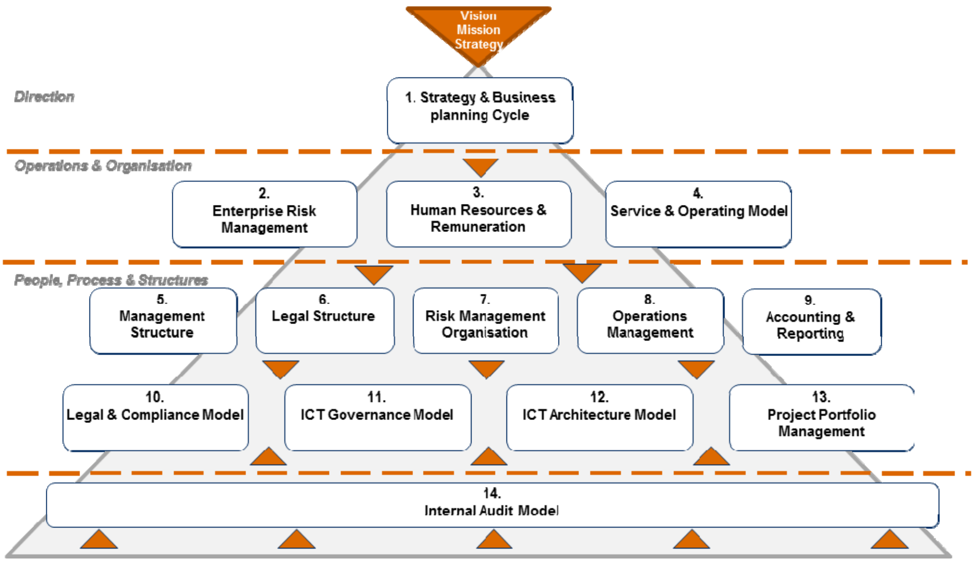

Figure no. 1: Governance model – as a practical example

Based on the principles of the corporate governance, which were presented in chapter 2 the introduction and methodology we asked the interviewees 6 questions. 4 out of 7 questions we asked the interviewees to rate the answer from 1 to 5. Where 1 means (excellent/ highly agreed) to 5 (bad/low level of agreement).

Question 1: Which are the main points, in terms of the principles which a good corporate governance will address?

Answer to Question 1: Most of the interviewees came out with the conclusion that a good corporate governance will address efficient and effective management, creating sustainable value, ways of achieving the firm's goals, increasing stakeholder satisfaction, increasing credibility, ensuring efficient risk management.

Question 2: In your company how would you scale the "right and equitable treatment of stakeholder" from 1 to 5.

Answer to Question 2: The outcome is by 3.5. The interpretation of this number means that the treatment of stakeholders is not equitable enough from the opinion of the managers we asked. This could be because of the different conditions and expectations of the stakeholders in terms of the level of involvement.

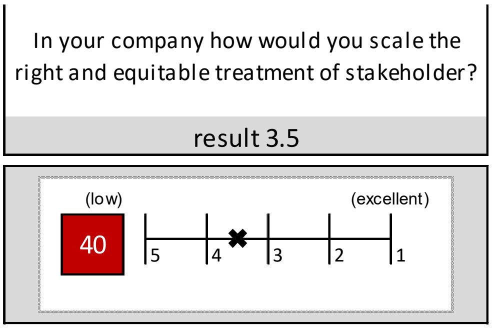

Figure no. 2: Interview results: Outcome of Question 2 – Source: authors

Question 3: Are the interests and accountability of other stakeholders well reflected in your corporate governance?

Answer to Question 3: The outcome of the question is rated to 2. This can be interpreted that the interests and accountability is clear, documented and working well within the corporate. That means the ownership of tasks and activity is defined and interpreted in the right content by the people involved in the governance process.

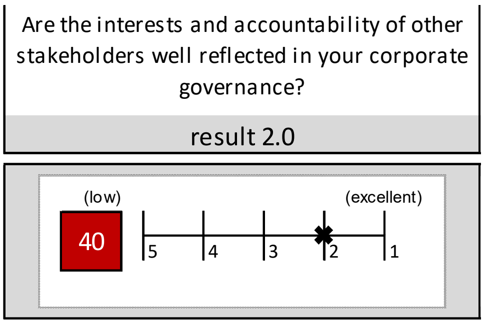

Figure no. 3: Interview results: Outcome of Question 3 – Source: authors

Question 4: Do you have well defined governance in terms of role, hierarchy and responsibility of the board implemented in your organization?
Answer to Question 4: The outcome of question rated by 2.5. This means it is acceptable rated there are some disagreements but also on the other hand more agreements that the hierarchy and responsibility is clear and logically. But again with doubts in terms of definition of the right roles and bringing the right people within the organization into responsible positions.

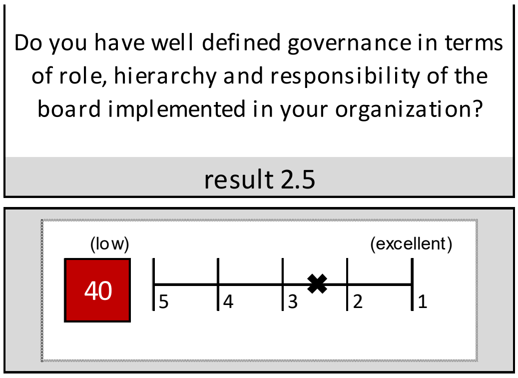

Figure no. 4: Interview results: Outcome of Question 4 – Source: authors

Question 5: Are you convinced that the corporate governance is used from the day to day perspective in an ethical way?
Answer to question 5: The interviewees have a skeptical view on that point. Ethically it is rated only by 4. Because they see a clash of interests in which the ethical way is not sufficient reflected on the governance. That means that it's sustainable and in terms of diversity and respectful approach of minorities and diversity of genders.

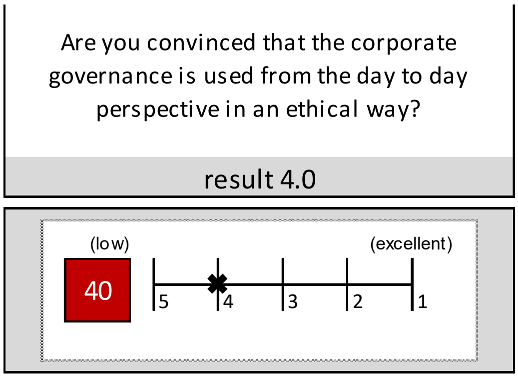

Figure no. 5: Interview results: Outcome of Question 5 – Source: authors

Question 6: Is the level of disclosure of information and transparency appropriate to your expectations on a well-defined corporate governance?

Answer to question 6: This is rated by 2, which is a high good level of agreement. This can be interpreted as the managers have access to the information, its transparent and the know how to use the information which they get from the board of management content and direction wise.
Further open question (no scaling answer): What would be a proper approach to set-up a different than these five principles described in chapter 2?
Answer: One of the main argument is to implement a rolling review and adoption of the governance principles. In addition the managers pointed out that there should be a clear assessment on the corporate governance and defined timeline on that - once in a while - to make sure that the principles are still well implemented, used and interpreted on a proper sustainable way and reflected in the organization. The interviewees did not doubt on the defined principles that these are the right one, but they came out with answer e.g. in terms of more reviews, regulations and higher level of transparency within the processes and measurements for improve of the current corporate governance in place.
To interpret the question on the authors figure 1 – Governance model. We can see 4 different level of hierarchy within this organizational structure. The direction is done by the strategy and business cycle process. The next level is the operations part of the companies let's say in other words the delivery center of the organization. The third level of "people, process and structures" is the support part of the organization. Let's say the third level used the guidance of the second to run the business on a support and structure level of activities. The audit model builds the fundament for this organization. To analyze the outcome of the questionnaire on that figure we can summaries that the roles and responsibilities are clear and implemented. From the ethical perspective this is an issue. Furthermore the manager response on the questionnaire is also that the implementation and review on the corporate governance should be performed on a regular basis. Review and adopt the corporate governance and allow transparency on the changes. In the figures above we can see that when an operations or process department changes or the responsibility changes this need to be structures and monitored in the corporate governance. It's also key to have a good risk management in place which is crucial to be part of the corporate governance (internal audit or risk management).
For further Risk management is correspondingly align with the business strategy, objectives, and key milestones. The key objective is to recognize critical situations in corporate activities at an early stage, to avoid those risks or mitigate them to reduce or minimize the effect of the risks. (Heinemann, et al 2016) It's also important for the process interaction management to have a stable and transparent corporate governance in place. Stability and transparency is important for the different level of processes management until the activity level as dysfunctional interactions between processes can have an important negative impact e.g. on the companies finance and development. (Mateescu, et al. 2016)

Conclusions

A well-defined governance is essential for a good over-all corporate performance. One of the perspective of corporate performance is that of stewardship and thus as the management of an organization is concerned with the leading of the financial resources of the organization, the management of the organization is concerned with the resources of society as well as the resources of the organization.

Again, the conclusion is that the corporate governance needs not only be defined, it needs to be implemented, adopted, reviewed frequently and if necessary after the review there should be changes on the structure aligned with the overall corporate strategy and vision. Future research activities will be focusing more in the corporate governance well connected with the risk management and integrated into all management processes, this will be better linked.

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