

Breaking

Corporate governance is about to enter a new phase. Alan Frost and Malcolm Lewis tell us why.

UNTIL THE END OF the Second World War, governments did not see it as their place to interfere with the running of private enterprise except to ensure that the public were not abused. In the UK the lessons of the South Sea Bubble of 1720, when nearly £220m was lost in schemes promoting trade with South America, had not been forgotten. From the Bubble Act of 1720 until 1824 companies as a means of trading were in effect outlawed, with exceptions granted by Acts of Parliament or Royal Charter. The Industrial Revolution at the end of the 18th century and the need for large sums of capital to finance the building of an infrastructure of railways, canals, and other transport systems forced the government to relax its hold. The growth of national, international, and global conglomerates over the past 50 years or so has once again forced governments around the globe to tighten the reins of accountability. There is now a requirement to monitor and enforce public governance in order to try to maintain a suitable balance between the state, the community, and private enterprise. A sub-set of this re-balancing is the management of the needs of key stakeholders in private enterprises, especially those of shareholders.

Changing emphasis

The cultures of North America, the United Kingdom, Australia, and South Africa have tended to be biased towards protection of the shareholder. Other parts of the world have emphasised different stakeholder models for governance and co-operation between the various parties. Currently we are experiencing a synthesis of these two worlds in which all parties form a critical chain for achieving success.

Specific problems have arisen in connection with the principle of agency under which directors act on

the mould

behalf of shareholders. There have been many examples of directors abusing their position of trust as managers or agents of the company's assets, which are ultimately owned by the shareholders. This has resulted in a number of major reviews including Cadbury (1992), Greenbury (1995), Hampel (1998), and Turnbull (1999). A legal framework of governance for executive and non-executive directors was proposed within these reports, with the aim of trying to protect the shareholders and stakeholders from director abuse. Two obvious examples are the establishment of formal audit committees to ensure that the financial accounts give a 'true and fair' view, and independent remuneration committees to monitor the pay and benefits packages of senior executives. Much of the approach is formulaic and prescriptive, although with the ultimate aim of re-balancing the powers between the board and the executive.

Powerful tool

More recently there have been other forces at work in addition to the prescriptive approach. The emergence of quantitative shareholder value theory has created a powerful tool for directors. The effects of social and ethical considerations in relation to the workforce and community are making an impact. There are also issues of organisational risk management to be considered, eg health and safety issues. The recent *Company Law Review* (2001) will encourage greater accountability and transparency by directors. All are reasons for pausing and suggesting a new model for the management of corporate governance.

Ann Robinson, visiting professor of the European Centre for Corporate Governance at Bournemouth University (and former head of both the National Association of Pension Funds and the Institute of Directors Policy Unit) outlined this historical perspective in a recent lecture, an extract from which was recently published, and argued her case for believing that organisations in the UK have reached the end of a ten-year 'process' phase and must move now to a very different level of corporate governance. We agree with her analysis and that of other commentators. What we call a new corporate governance 'leadership paradigm' is essential to achieve the next phase of development. The events of 11 September 2001 have created a heightened sense of awareness of the importance of values in a personal and corporate sense. These values need to be aligned with existing requirements to give greater satisfaction and meaning to our working lives.

Holistic model

We propose that a high-level, more holistic mental model for governance is needed by boards and management teams in order to deal with all these differing demands.

The new paradigm is one in which governance is considered to be the oxygen of corporate survival, not simply a set of checklists or procedures. Governance should be a matter of attitude and mindset and needs to concern itself with not only the personal and corporate values that individual and groups of people hold, but also the corporate value that organisations need to create and understand in order to manage and satisfy their shareholders. One of the authors proposes that, by linking the soft issues of 'values' with the harder aspects of 'value', a wealth management model can be created. Consensus on the balance between these two aspects is a matter of dialogue between the stakeholders. It is self-evident that without effective communication no organisation can expect to optimise all key stakeholder aspirations.

Striking the balance

The new 'SuperLeadership' of Manz and Sims concerns itself with helping and empowering others to lead themselves through a set of moral guidelines. In other words, we should understand and define our personal values and then attempt to align them with those of the larger groups that we exist and operate within. Under this type of so-called 'mental model', people in organisations should manage the overall value of the organisation within which they operate, taking account of all the stakeholder interests, including shareholders. They should aim to consider and manage all risks effectively. There should be a transparency of future strategy and action as required by the company law review. All of these aspects then need to be enclosed in an ethical board behaviour that strikes a balance between achieving the organisation's aspirations and motivating the management in a way that encourages them to consider the community at large as well as their own personal gains.

If the proposed extension of directors' liability comes about, it is likely that shareholders will sue directors for failure to act in accordance with their moral, ethical, and fiduciary duties. The battle lines for improper director behaviour have been drawn. The pressure is going to increase the requirement for managers to proactively manage all aspects of the business. The recent collapse of the energy giant Enron may turn out to be yet another sad example of poor management and adviser ethics leading to the loss of many billions of dollars-worth of personal pensions and savings.

The guardianship of moral, legal, and fiduciary behaviour on behalf of stakeholders is formally the responsibility of directors. The responsibility to behave ethically and in accordance with an organisation's values is the duty of every member of the organisation. □

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