HARCOURT BOARDROOM RESOURCES

WHO OWNS CORPORATE GOVERNANCE?

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THE GOVERNANCE ELEPHANT IN THE ROOM

Twenty years ago, while being part of a studying group on entrepreneurship at University of Stirling brand new work of Peter F. Drucker hit bookstores of that colorful ancient Scottish town. The beginning of the book reads: "Every few hundred years in history there occurs a sharp transformation. We cross the "divide". Within a few short decades, society rearranges itself – its worldview; its basic values; its social and political structure; its arts; its key institutions. Fifty years later there is a new world. And people born then cannot even imagine the world in which their grandparents lived and into which their parents were born." It is almost impossible to find shorter and more effective description of the times we live in! Governance of companies in the era of knowledge society, and disruptive technological change has become as important for the global economy as is governance of the countries.

The Middle East and North Africa (MENA) and South East Asia have made significant headways in corporate governance in last decade. Most countries have now issued corporate governance codes for listed companies and there is growing awareness of the need to address corporate governance in the non-listed companies as well. The next major challenge is implementation, anchoring new realities in the culture of organizations. The question asked on a daily basis is what are the good practices of implementation? Who should be driving the process to ensure effective and meaningful implementation of corporate governance within their organizations, or, in other words, who owns corporate governance?

There is much unwarranted confusion in this area. The confusion begins with the term "corporate governance" itself in that the term tends to be defined in a variety of ways, depending on which book or code one follows. The reality is that the complexity of governance is difficult to capture in a simple definition. Similarly, governance is also a highly contextual concept and it requires a great deal of reflection on the needs of the business and on the corporate governance principles and their rationale before they can be applied.

The second main source of confusion stems from the fact that corporate governance is a wide subject area. Topics such as board practices, director duties, audit, executive remuneration, compliance, risk management, and shareholder protection all fall under its umbrella.

In a famous story five blind men were touching different parts of an elephant and describing the elephant according to the part they were touching. The first blind man touched the leg and reported the elephant to be a tree trunk, the second man touching the stomach said the elephant was a wall, and the third felt the ear and concluded the elephant was a fan. The fourth touched the tail and described the elephant as a piece of rope and the fifth blind man felt the elephant's tusks and described it as a spear.

Corporate governance perceptions share some striking similarities with the elephant in the story. The governance ecosystem is large and there are many actors within governance, and the parties do not necessarily share the same understanding, as are their interests in governance very diverse. Banks see the value of good governance from a different perspective than customers or suppliers, as are the interests of employees quite divergent from analysts or rating agencies. Corporate lawyers or internal auditors see the governance world through their relatively narrow lenses. Despite (dis) alignment of the views, they all matter. The role of the Board of directors is to understand that governance encapsulates all these elements, but it is their job to see the whole. This could be a reason why a “ten thousand feet view” in governance is needed in order to see the whole picture and set the system accordingly. In other words, it is the board of directors that should have ownership of corporate governance.

THE ART OF STEERING COMPANIES

It is worth reflecting on the creation of companies. How are companies set up? Everything starts with the Vision (setting the direction) – a vivid description of future in a way that touches people’s hearts, lifts them to higher level of moral aspiration and moves them to act. The power of vision rests in its ability to define a future that connects individuals within the organization with the service of noble ends beyond themselves. The vision should define something worth contributing to, something that brings meaning to the individual life. This aspiration in corporate governance begins with the company’s purpose. Why does our company exist? What is the “raison d’etre” behind the creation of great companies capable of exceptional and sustained achievements? Economic and social forces are converging in ways never before experienced by humankind. The knowledge, cooperation, commitment and hard work of individuals are what the competitive advantage is made of.

Owners of the company provide capital to fulfill that purpose and managers work to reach those goals. Boards are set up to oversee the management on behalf of the owners and they are collectively and legally responsible for the long-term success of the company.

In other words, the role of the board is to act as the interface between the owners and the managers. There should be equilibrium between these three key governance actors. In the run up to the financial crisis for example, it became evident that in many Western financial institutions the balance had been shifted to the side of the management. In some state-owned companies, the balance is often heavily on the side of the state, where a Ministry decides what the management should do for a political end without understanding the business realities. It is the role of the board to provide the adequate balance, while maintaining the company's vision.

The term "governance" derives from the classical Greek, "*kubernetes*", and it has two meanings. The first one is "steersman" or the "helmsman" of a ship. Corporate governance, in other words, is "the art of steering organizations." While the management does the sailing, it is the board that should provide the direction. The key point is that the board and the management are in the same boat and because of this there should be a mutually respectful partnership between the management and the board.
Sailing without steering or steering without sailing is akin to one hand clapping – governance is about ensuring the effective interplay between these two functions. And this takes us to the second meaning of the term "*kubernetes*" which refers to the concept of cybernetics or feedback systems. Feedback can be very useful - particularly for control. Consider the case of the steersman responsible for ensuring a boat follows the intended course despite the effects of winds and tides. If the boat is off course the steersman takes the appropriate action, turning the rudder left or right, to get back on course.

In practice, too often corporate governance is associated with control and compliance. Governance is about steering, not about braking. It is worth bearing in mind the UK's Corporate Governance Code which states that "the board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed". The focus tends be on the word "control" while the words "entrepreneurial leadership" are overlooked. An effective governance framework is one that provides long-term value to the company, not only in terms of controls, but also in terms of strategy and vision.

And as an art, corporate governance is not about rigidly following rules and regulations. The so-called best practices serve as useful benchmarks against which companies can self-assess their current practices. But corporate governance is not a box-ticking exercise.

The onus will be on the companies to implement principles of corporate governance in a manner that is practicable for them, taking into account their own individual circumstances and needs. A good starting point is the realization that boards, CEOs, CFOs, owners, etc. should not be seen as objects of corporate governance, but as subjects of corporate governance.

GOVERNANCE AS LEADERSHIP

Queen Christina of Sweden in the 17th century is reported to have stated that "in the art of governing, one always remains a student". And effective boards are those that are learning boards. The reality, however, is sadly different - as John C. Whitehead, a highly experienced board member, once put it: “When it comes to governance, everyone is an expert”.

Being an effective board member is all about learning and relearning. Boards not only evaluate the performance of the CEO, but also take the formal assessment of their own work seriously and use the findings to develop, and hold themselves to, objectives for improvement. The effectiveness of boards does not center around on the number of board meetings in a year or on the length of these meetings as these are likely to be dependent on the nature of the business, but on the (often unwritten) rules guiding the behavior of directors and determining the character of dialogue.

Boards across the world have had to rethink their own role – how to add value. Particularly in the aftermath of the financial crisis where much of the blame for it was placed upon the absence of board oversight, boards have started becoming more vocal. The danger here is that many boards have moved from being passive boards to “intervening” boards. The role of the board is to govern, not to manage. Boards will never know the business as well as the management (and if they do, they have the wrong management team). The appropriate balance is an engaged board, one that understands the business, scrutinizes the management in good times and supports the management in challenging times. An engaged board governs the strategy process, links strategy and risk and sets the company’s risk profile. The approach of an engaged board is not “hands on”, but ”brains on”.

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