Martin Hilb

New Corporate Governance

Successful Board Management Tools

Fourth Edition

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Foreword

Fifteen years ago, we started to offer annual doctoral seminars in corporate governance and seminars for chairpersons and members of boards at the University of St. Gallen. In 1995, we published an "Integrated Board Management" concept and suggested that the board has to be developed as a team responsible for directing and controlling an organization (see level 4 in Fig. F-1).

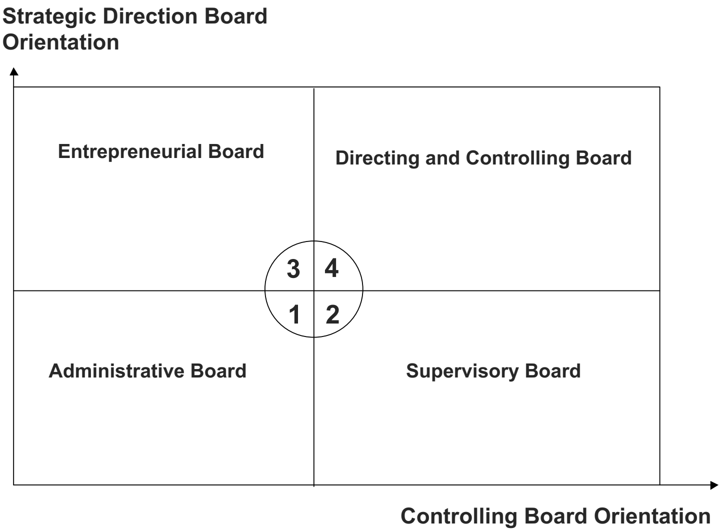

Fig. F-1. Development levels of boards

It is a great pleasure to publish the fourth English-language edition of this book within just less than three years. We thank the readers for their valuable feedback on the third version.

The subject of corporate governance has become highly topical worldwide because of the many corporate crises that have occurred – in both countries that promote shareholder-value governance approaches[1] (such as the United States or Great Britain) and countries that strive for stakeholder-value governance approaches[2] (such as Germany or Japan).

Depending on the value system prevailing in a particular country or context, corporate governance has been seen to deal with "the protection of shareholders rights or... the rights of all, or at least a part of the stakeholders." [3]

In research as well as in practice, the common assumption is that there are just "two basic models of corporate governance systems: the first model is the Anglo-American 'market based' model, which emphasizes the maximization of shareholder value, while the second model is the 'relationship-based' model, which emphasizes the interests of a broader group of stakeholders."[4]

In this book however, we introduce a third way – "New Corporate Governance" that integrates the strengths of both approaches. We thereby avoid the traditional question of which approach should be used as a basis for corporate governance: the widely used, Anglo-American, shareholder-value approach or the stakeholder-value approach, which is found in a variety of forms.

We propose a both-and, glocal approach. In other words, we adopt both the global relevance of aspects of the Anglo-American board best practice (exemplified in Canada, New Zealand and Great Britain and adopted sometimes with little or no critical analysis in developing nations[5]), and the local governance best practices evident in the approaches adopted by many international firms operating in countries around the world. Companies only generate enduring success if they add value in all their activities for shareholders, customers, employees and society. Thus it is important for

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1 See Rappaport (1986) and Stewart (1991).

2 See Freeman (1984:31), wherein stakeholders are defined as: "those groups without whose support the organization would cease to exist."

3 Wentges (2002:74).

4 Tabalujan in Hasan (2002:488). See also the definition of corporate governance proposed by Shleifer and Vishny (1997:737) for an example of a pure shareholder model and Preston and Donaldson (1995) for a discussion of stakeholder orientations.

5 See Ahunwan (2003).

each board to determine the manner in which stakeholders share in firm success, according to that firm's requirements. For example,

- 50% shareholder value added (based on EVA)[6]
- 20% employee value added
- 20% customer value added
- and 10% public value added.

In each case, the requirements, the satisfaction and the voluntary loyalty of these stakeholder groups could be measured periodically, using an integrated feedback toolkit, for example.[7]

In response to the growing interest in corporate governance, we founded the IFPM Center for Corporate Governance, in order to focus my research, teaching and consulting activities in a targeted way using this integrated approach (see www.ccg.ifpm.unisg.ch).

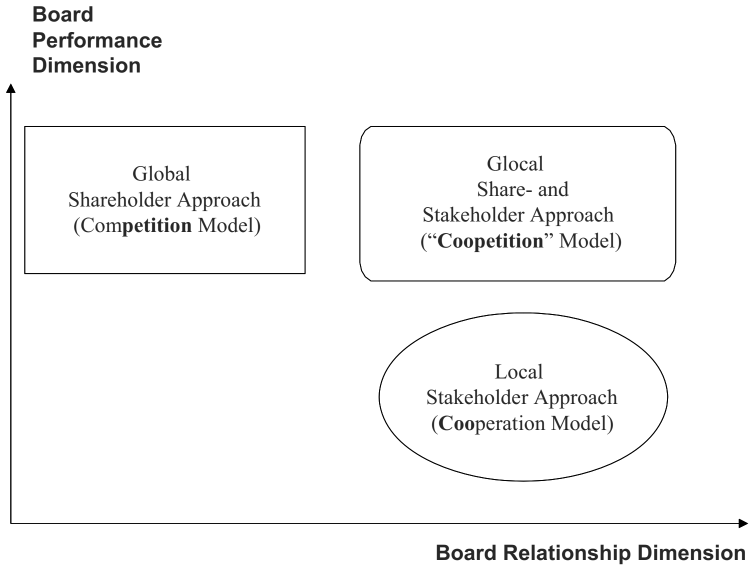

Fig. F-2. Models of corporate governance

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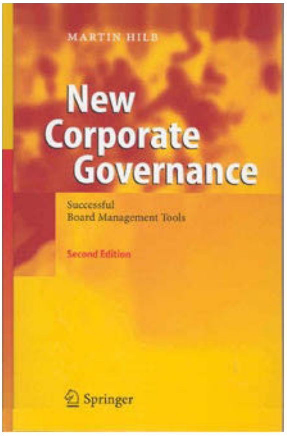
6 See Stewart (1991).
7 Such as that developed by Hilb (2003).

This book has been published in several languages:



4th edition
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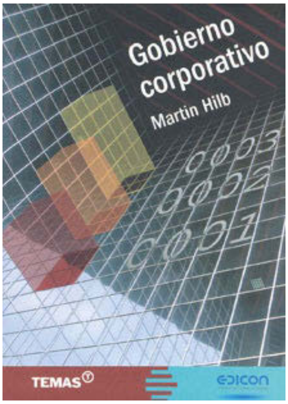
Saigon 2007



1st edition
Buenos Aires 2007

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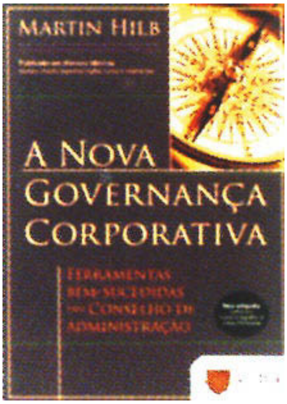

1st edition
São Paolo 2009

We would like to thank all the people who made contributions to the completion of these book versions. Firstly, we thank the chairpersons who have given us the mandate to implement new board concepts and carry out board evaluations on their behalf. Secondly, we thank the numerous participants of our board seminars, board network workshops and annual doctoral seminars on corporate governance at the University of St. Gallen, for the many valuable contributions.

Special thanks go to the following academics and associates of our Institute: Professor Roman Lombriser for his valuable remarks; Dr. Ursula

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Special thanks also go to all those individuals who prepared other versions of this book into other languages:

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- Prof. Dr. Trung Dinh (Vietnamese);
- Ms Erica Maidana (Spanish);
- Dr. Olena Kos (Russian);
- Luiz F. Turatti (Brasilian).

Last but not least, I would like to thank Dr. Werner A. Müller of Springer Publishers for his valuable support with the simultaneous publication of both the English and German versions of this book.

St. Gallen, July 1, 2011 *Martin Hilb*

PART 0

Introduction

0.1 Background

In recent years, the topic of corporate governance has gained prominence as a result of the large number of attention-grabbing corporate scandals at the board level. What was formerly a topic of interest to academics has become a burning issue worldwide for researchers and practitioners alike.

> 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."[8]

- **In research**, the above mentioned "mis-developments" made it increasingly clear that underlying theories were used in an undifferentiated and onedimensional way. For example, the much-applied *agency theory*[9] has the following failings in corporate governance research:
  - "Much of agency theory … unrealistically assumes that earnings and stock prices cannot be manipulated."[10]
  - "Traditional agency theory builds primarily or exclusively on extrinsic motivation."[11]
  - Only the needs of top executives and shareholders (and in the worst case only the needs of top executives) were taken into account, but not the justifiable needs of employees, customers or the environment (the public realm, the natural environment or the heritage of future generations).
  - Finally, agency theory could not "… account for key differences across countries."[12]

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8 Newing (2003:6).

9 See Berle and Means (1932), Jensen and Meckling (1976), Eisenhardt (1989) and Aguilera and Jackson (2003:448ff).

10 Implying that some of the incentive systems in common use do not generate the alignment between principals and agents for which they were supposedly designed (Brecht et al. 2002:47).

11 Frey (2003:4).

Hilb, *New Corporate Governance*,
DOI 10.1007/978-3-642-23594-8_1, © Springer-Verlag Berlin Heidelberg 2012

It has become evident that the role of the board should be handled in a more differentiated and holistic way. Corporate governance research should take into account the diverse roles that boards play.[13] For example:

Resource dependency theory suggests that board members can play valuable roles in making resources available to, and in coaching the CEO. Thus the art of board leadership could be "to build and maintain trust in [directors'] relationships with executives, but also to maintain some distance so that effective monitoring can be achieved."[14]

Stewardship theory[15] suggests that top managers can act in the best interests of the company even when financial incentives and monitoring systems are not in place to ensure that this is the case. Under such circumstances, the role of the board shifts from monitoring to support in strategy formulation and implementation at a high level.

And, *institutional theory*[16] attempts to understand corporate governance in the context of social and cultural constraints imposed on organizations.

In the past, most research has addressed corporate governance from a single perspective. In the future it will be increasingly important to approach corporate governance from an integrated and "multi-theoretic" point of view. In this regard, Hung presents a valuable research-typology[17] – one that can serve as a compass to orient users of the model presented in this book (see Fig. 0-3).

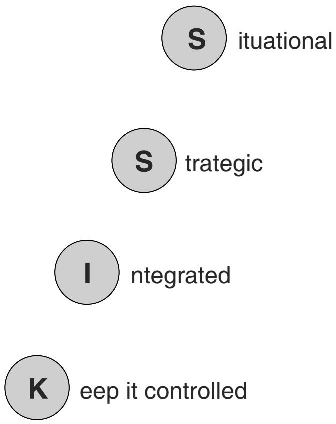
- **In education,** a limitation of corporate governance can be described as follows[18]: 'One shortcoming has been the tendency of textbooks in the area to make prescriptions about the 'best practice' … without providing a credible analytical framework for the students or the practitioners."[19] There is a severe deficit of integrative corporate governance concepts. An analysis of the development stage of teach-

12 Aquilera and Jackson (2003:448).
13 See Hung (1998:105).
14 Daily and Canella (2003:376).
15 See Davis et al.(1997).
16 See Aoki (2001).
17 Hung (1998:105).
18 These limitations apply equally to human resource management (HRM).
19 Boxall (1992:60).

ing shows that, as with HRM, "the future academic strength of corporate governance will depend on how effectively present scholars dedicate themselves to building credible analytical frameworks – focused at the level of the firm but with the capability of providing an adequate disciplinary basis for comparative corporate governance."[20]

0.2 Objectives

This book presents an integrated corporate governance framework: "New Corporate Governance". This framework addresses the weaknesses of research, education and practice. "New Corporate Governance" is based on a reversed "KISS" principle:



This holistic framework for the direction and control of enterprises integrates formerly isolated elements of corporate governance in research, teaching and practice.

Part 1 of this book analyzes the situational dimension of corporate governance based on constructs developed in institutional and situational theory.[21,22]

Part 2 analyzes the strategic dimension of corporate governance based on stewardship[23] and role[24] theories.

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20 Boxall (1992:75).
21 See Aoki (2001).
22 See Fiedler (1967).
23 See Davis et al.(1997).
24 See Neuberger (1995).