A String Theory
Deep-dive Report

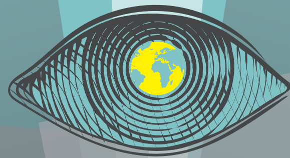
Great governance: Why sustainable value is a non sequitur.

CAUX ROUND TABLE GLOBAL GOVERNING BOARD

THE CURRENT CRISIS OF GLOBAL CAPITALISM - FIRST IN FINANCIAL MARKETS AND NOW IN A RECESSIONARY DOWNTURN IN CONSUMPTION AND PRODUCTION - REVEALS THE DEPENDENCY OF BUSINESS ON AN UNDERLYING SOCIAL CULTURE OF TRUST AND RESPONSIBILITY.

PRINCIPLES ARE NEEDED TO RESTORE VITALITY

TO GLOBAL FINANCIAL MARKETS AND TO GUIDE BUSINESS OWNERS AND MANAGERS.



THE CAUX ROUND TABLE WAS FOUNDED IN 1986 BY FREDERICK PHILLIPS, FORMER PRESIDENT OF PHILIPS ELECTRONICS AND OLIVIER GISCARD D'ESTAING, FORMER VICE-CHAIRMAN OF INSEAD, AS A MEANS OF REDUCING ESCALATING TRADE TENSIONS.

AT THE URGING OF RYUZABURO KAKU, THEN CHAIRMAN OF CANON, INC., THE CRT BEGAN FOCUSING ATTENTION ON THE IMPORTANCE OF GLOBAL CORPORATE RESPONSIBILITY IN REDUCING SOCIAL AND ECONOMIC THREATS TO WORLD PEACE AND STABILITY.

Why we need to talk about Governance

The opening quote makes a key point. The stability of the world in which we live today is dependent on – amongst other things – conditions in global business markets.

The corporation has become the dominant institution of our time. As such, you might imagine its governance would be a subject of great interest to senior executives. Yet, when we tabled the topic of the current research it was met with a lukewarm response by some. "Isn't that a bit dry?" We were asked. "Won't it be boring?" It's anything but.

The history of corporate governance makes for a ripping read, littered as it is with astonishing tales of corruption, greed, lies, human, animal and environmental harms and abject financial failures – all directly attributable to inadequate governance. You couldn't make this stuff up.

And yet, a little like politics, the very word induces torpor. It shouldn't. Perhaps its etymology sits too closely to 'government', with which scholars identify us as increasingly dissatisfied and disconnected. But the processes of governance describe the origins of the institutions of state, not their outcomes.

The great governance scandals of the last century have the potential to be the impetus for positive change if we are able to recognise that the world really has changed and that shifts in direction, greater transparency and absolute accountability can be mechanisms of improvement as opposed to brakes on progress. Governance delivered through the holistic, principle-driven models emerging in the literature of recent years has great potential to deliver on the promise of sustainable value. But the ability to genuinely bring such approaches into common practice will require a paradigm shift from commercial interests, not from scholars.

Current reality is still driven predominantly by share price, profits and short-term horizons. Regular catastrophic failures with serious social repercussions continue to punctuate the decades. Each fresh wave of disasters brings a new set of regulatory responses, but no genuine change. This is because authentic transformation ultimately requires a cultural reply. This report argues that if we can reassert some more human drivers into the head of the machinery of commerce, we might just get there.

Contents

8
Executive Summary

21
Challenges within the model: Problems and opportunities

38
What does good look like? A potential way forward

44
GE: Turning Customer Feedback into Business Opportunities

The storm of the financial crisis hit with full force in 2008 through 2009. The impact of events over that period and in the years since has been the profound and lasting damage to the strength and stability of the global economy, political upheaval and devastation of the lives of ordinary people whose financial and personal security were placed at risk by those engaged in the reckless pursuit of profit. In the midst of all this, the confluence of economic, political and social repercussions triggered a momentary shift in collective consciousness as to the implications and consequences of irresponsible capitalism. With it came a broader appreciation of the fact that, just as with the accounting and governance scandals that rocked markets a decade before, the web of laws and rules designed to keep business in check prove insufficient protection from those intent on pursuing selfish interests with disregard for and at the expense of others. Simply put, the harms inflicted on the financial and broader social-economic system stemmed from conduct that while technically legal was not ethical. ”

– Dr Alison Dempsey Lawyer - Governance, Ethics, Conduct & Compliance.

58 Manila Water Company: Reaping thebenefits of stakeholder engagement

60 Last words

62 A Tool to add to your governance toolkit

66 References

Executive Summary

Since the epic events of the '90s, the topic of governance has become mainstream; the subject of robust and ongoing debate. As with so many important subjects there is no common agreement on how it should be defined or enacted. In its broadest sense the term can be considered as referring to all the processes of governing (as distinct from the institutions of Government), whether undertaken by state, market or network, whether over a family, tribe, formal or informal organisation or territory and whether through laws, norms, power or language. In this report the focus of attention is on the governance of organisations. However, this wider context is a reminder that organisations always exist within a broader network of resources, systems and organisms. What becomes clear through the research is that this location within broader social and environmental systems is not generally being made.

Internationally there is no 'one-size-fits-all' approach to governance due to differences in legal systems, cultural traditions and institutional frameworks. There are, however, some common and timeless principles. In a world where investors and goods are increasingly mobile and borderless we will certainly need them. In examining the models that currently exist, it becomes clear that all is not well. There is a growing agreement that the current dominant model of delivery (Anglo-American) in particular is far from adequate. The major philosophical schism that exists between this model and proposed alternatives can be boiled down to philosophical orientation. The dominant Western model has become focused on shareholders (and shorter-term profits), whereas the expanded focus increasingly advocated (but not necessarily enacted) is one in which governance is defined as being concerned with the longer-term management of diverse interests of various stakeholders and environments.

This report's view is that if we can move to locate governance within a more principle-driven framework, attention to wider stakeholder interests and longer-term horizons will necessarily be the result. In addition, current failures will be better mitigated and sustainable business viability better assured. However, such a shift will require significant cultural changes to be successful. There are moves towards this framework playing out globally. In reality we have barely started the discussion. There is a lot of work to do.

This report examines governance through the following questions: How did we get to where we are today? What is wrong with current models of governance and why? What are potential principles and frameworks for 'good' governance? How can you optimise performance of a board?

In the end the evidence seems to suggest that scarcity of resources and negative impacts on environments will compel consideration of a much more human and context-aware approach to governance than has manifested in the last century. Whether we will go there fast enough remains to be seen.

SHARE

STAKE

HOW DID WE GET HERE?

> There is no definitive historical treatment of corporate governance and there may never be one, given the vastness of the subject.

– Brian R. Cheffins, from his working paper The History of Corporate Governance (2011) [1]

A brief history

Cheffins is right. This is a vast subject. Addressing all relevant aspects of this topic in a systematic way would be an impossible challenge. What is offered here is a journey through the development of the dominant Western model to which most of us work today. The history of governance in business and industry is tied to the history of corporations. Technically the term 'corporation' describes just one form of business ownership, but when attached to the word 'governance' it has become common shorthand for any business or organisation. The history is not recent [2]. In India as far back as 800 BC a type of organisational form (dominantly known as Sreni) was being used for every kind of business, political and municipal activity. Like corporates today, Sreni were seen as legal entities that could hold property separately from owners, construct their own rules for governing the behaviour of members, and contract, sue and be sued in their own name. Fast forward into Rome (AD 500s) and corporate entities such as municipalities, private associations, political groups and guilds of craftsmen or traders were also recognised and, similarly, had rights to own property, make contracts, receive gifts and legacies, to sue and be sued, and, in general, to perform legal acts through their representatives [3]. Examination of the way in which these historic entities were structured, governed and regulated identifies many similarities to modern systems. The notable difference is that they were understood as part of and answerable to a wider social context, a distinction that has been lost in the dominant Western model of today.

The emergent logic of contemporary Anglo-American governance came later on the human timeline. The key driver was an appetite for expansion by 17th century Europe's ruling elite as they reached out geographically. Nations chartered corporations to lead colonial ventures, such as the Dutch East India and Hudson's Bay Companies – the Western forerunners of today's models of corporations and governance. Initially these companies acted on their government's behalf, with considerable political and military involvement and power. As ventures they soon became focused on private revenue generation.

The monies involved were substantial, both in terms of capital and return. By 1611, shareholders in the East India Company were reported as obtaining almost 150 per cent ROI from their investments. Subsequent public stock offerings raised £418,000 (1613–1616) and £1.6 million (1617–1622). For the 17th century these were serious amounts of money. UK investors, enticed by extravagant promises of profit from trading companies, bought into shares with enthusiasm. One entity, the South Sea Company (est. 1711), created particular excitement as it had supposed monopoly

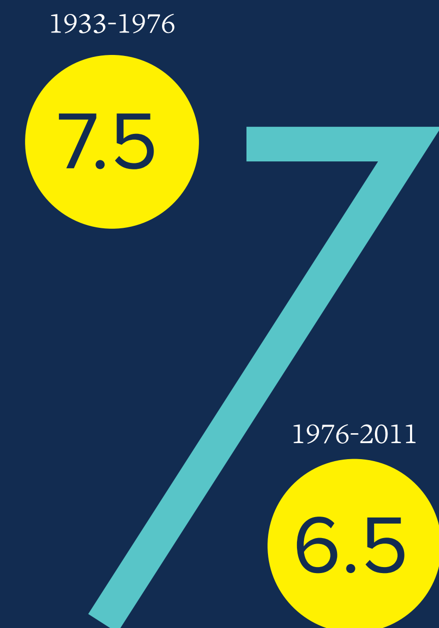
rights to trade in the Spanish South American colonies. This was backed by the Treaty of Utrecht following the War of Spanish Succession, which gave the United Kingdom an 'assiento' to trade in the region for 30 years. In reality, the Spanish were still hostile and let only one ship a year enter. For the time being, truth did not matter. By 1717 the South Sea Company was so wealthy from investment, despite having done no real business, that it assumed the public debt of the UK government. This move accelerated the inflation of its share price. It rose so fast that people began buying simply in order to sell at a higher price, which in turn led to further inflation of share prices. This was the first speculative bubble the country had seen. By the end of 1720 the bubble had burst and the share price sank from £1000 to less than £100. As bankruptcies and recriminations ricocheted throughout government and high society, the mood against corporations and their errant directors was bitter. This and other losses brought restrictive legislation and an end to the first era of such stock activity [4].

The colonial appetite for expansion has not been the only driver of development. Historically, the pragmatic reduction of risk and recognition of the power of what a collective can achieve over an individual has also played a part. Growth in the amount of goods produced, particularly after the Industrial Revolution, created opportunity for people to travel further afield to sell things. Travelling has not always been easy, especially if traders are moving through foreign and dangerous territory or using methods subject to risk (think of the pirated trade routes still with us today). In these circumstances, being in a group can offer protection and a way of spreading risk; an incentive for collective thinking and effort.

Similarly, working collaboratively offered economies of scale and spread of fixed costs. Technological advances, like those in the Industrial Revolution, were initially extremely expensive, but where large amounts of capital could be raised cooperatively the technologies on offer could be used by a group of smaller businesses or by communities. In this way the benefits of collective effort or capital – especially for public works – influenced the increased development of, and demand for, organisational forms [5].

Which model returns?

Roger Martin, the former Dean of the Rotman School of Management at the University of Toronto, has calculated that from 1933 to 1976 (roughly the era Pearlstein [9] describes as ‘managerial capitalism’, in which managers sought to balance the interest of shareholders with those of employees, customers, and society at large) the total real compound annual return on the stocks of the S&P 500 was 7.5 per cent. From 1976 to 2011(roughly the period of ‘shareholder capitalism’) the comparable return has been 6.5 per cent [12].



Total real return P.A of the S & P 500

Although rather oversimplified, these examples highlight the different logics of the two models of governance: one driven by a greater focus on profits, the other more as a response to the needs of stakeholders from wider communities.

As corporate entities emerged and proliferated, so did the need for mechanisms to monitor and measure the actions of their owners and managers. Methods were clearly required to ensure appropriate actions inside the business but also to manage the impact and influence of the business on its community. Again, this was not a new issue. Back in 800 BC the Sreni of India usually had the equivalent of a written corporate constitution, with democratically developed policies and an external system of monitoring. Obligations included requirements such as the need to address conflict of interest and duty of care [5].
As highlighted above, in ancient India the entity was not seen as isolated from its community and recognition of the complexly interconnected role of Sreni with the country's economic prosperity saw the governing power tread a delicate political balance. Regulation ensured increasingly wealthy businesses were sufficiently under control that they could not present a significant challenge to the ruler, but the governing body also ensured support for Sreni because they helped maintain an active economy. So despite monitoring, Sreni tended to be given considerable internal freedoms with a reliance on principles as opposed to rules to keep them in check. As with the history of the colonising companies of Europe, this story points to the necessary recognition of the relationship between business, community and state – with ancient tensions visible in contemporary narratives.

If we cross the ocean of history to the United States, things were initially different from what we have today. Early corporations were usually constructed as subordinate entities and set up specifically to serve the good of the community – often charged by the state to perform a particular function, such as building a bridge or supplying water [6]. Mechanisms of control included prescribed limits as to what they could do and how they could operate, and any shareholders were fully liable for conduct and outcomes [7]. It was the lure of profit that changed things. Civil war and the Industrial Revolution created significant opportunity to access public money as states sought to facilitate progress in areas of transport and infrastructure. Some private firms, like Carnegie Steel Company and Rockefeller's Standard Oil, simply sidestepped the restrictions of the corporate model and formed trusts. Unsurprisingly, there was strong appetite within corporations to remove limitations on their form. They needed a tool for change.

It came in the form of the 14th Amendment. Set up to gain rights for newly freed slaves, the 14th was designed to protect the rights of the person through the US Supreme Court. Corporate lawyers saw a different opportunity: they argued that the corporation is, in principle, a legal 'person' and deserving of the same protections for capital and property. Intellectual sophistry of course, but it worked. The mechanisms restricting corporations

were undone. One is left to speculate as to whose interests were ultimately best served by the amendment: between 1890 and 1910 the court considered 307 cases seeking justice under the 14th Amendment. Of those, 288 were brought by corporations and only 19 by African Americans [6].

Back in the United Kingdom the opportunities sparked by the Industrial Revolution also created similar pressure for legal changes to facilitate business activity. The significant changes enacted in the UK saw the repeal of restrictions and a series of new 'regulations': the Joint Stock Companies Act 1844, the Limited Liability Act of 1855 and the House of Lords' decision to confirm the separate legal personality of the company – in effect establishing the liabilities of the company as separate and distinct from those of its owners.

For the US and the UK these more permissive corporate laws meant rapid growth in business. Initially, most corporations were smaller but soon larger businesses emerged that required the appointment of managers who might not have any vested interest in the company. This led to the creation of formal oversight between management and owners or stockholders of the business in the form of boards [7]. Debates began about the proper purpose of these large organisations. Should these publicly-held businesses simply exist to serve the interests of their shareholders? Or should they have a broader social purpose that addressed the interests of customers, employees and perhaps even society as a whole? [8]

Such discussions were inevitably amplified at times of failure. No one era was devoid of scandal. A timeline from the birth of stock markets in 1611 to today reveals a litany of frauds and failures. In 1929 the crisis caused by the most significant burst investment bubble yet – the Great Depression – could have marked the moment different interests came together over the wider social role of business; the social impacts were huge and international. Instead, corporate economic logic became the tool used to respond to the crisis. The outcome was to consider the nation as a business and GDP as the measure of how that business was doing. This model simply replicated a problem: the costs of resources required to produce and the likely social and environmental impacts of production and consumption were omitted from consideration.

Instead of seeing a need to examine the logic of any socially disconnected model, the 20th century saw an ongoing proliferation of laws allowing for the expansion of corporations by registration across the world. Western business logic became international and the financial and potential social implications became very large indeed.

Despite the monies involved, up until the '60s the Western corporation was not yet all about profit. There was still a certain sense that a company belonged in, and owed something to, its community [9]. Then the hint of a new narrative began to emerge. In 1970 free market economist Milton Friedman (University of Chicago) published a New York Times Magazine essay, entitled 'The Social Responsibility of Business is to Increase its Profits' [10] in which he argued that "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits." Anything else, he argued, was "unadulterated socialism."

It took another 20 plus years for the new and now dominant narrative to take hold, but by 1997 the US Business Roundtable's view was echoing Friedman's. "The principal objective of a business enterprise is to generate economic returns to its owners…" it declared in a white paper on corporate responsibility [11]. The shareholder had become the primary concern of business – along with the stock price.

Although there wasn't an immediately obvious impact, it is now recognised as flagging that something was in motion culturally. So what was the impetus behind the shift? Poor profits. Global markets and internationalisation worked both ways and this meant global competition. Increased competition had gradually eroded business margins to the point of pain. Stock prices and shareholder returns through the '70s had lagged badly. As stock prices slumped, attempts by rivals to target and take over companies became common. And shareholders, disappointed by the failure of the previous decade, were now willing to sell. Executives suddenly had to focus squarely on profits and returns to keep the business. Inhibitions about laying off workers, cutting wages and benefits, closing plants, spinning off divisions, taking on debt, or moving production away from local communities to cheaper options overseas disappeared almost overnight. Firms had a clear governance focus: 'shareholder capitalism' [9]. Over the same period, a number of other dynamics were reshaping the business environment. Many countries with large state-owned corporations were moving towards privatisation, selling off publicly owned services and enterprises to corporations focused on profit. This saw private, short-term, market-based investment and performance become more important than social interests. A concurrent investor shift saw a move away from a focus on long-term investing and towards short-term trading. Mutual societies and partnerships went to public markets to seek investment and converted themselves into listed corporations, with resultant changes to their governance structures. Firms grew in size and financial intermediaries and institutional investors became significant players in the shareholder community – all focused on short-term returns. Executive rewards became attached to stock performance, as options became a standard part of the executive package. Time horizons shortened inevitably as a result, due to their length of tenure. As the century moved to its close, corporate activity continued to expand its remit through a mix of technological progress, liberalisation, deregulation and opening up of financial markets and a series of structural reforms. Capital was king and increasingly mobile. All of this created a situation in which the allocation of capital among competing purposes became ever more complex, as did monitoring of the use of that capital and its systems. It was a dangerous mix.

In 2001 Enron collapsed in the largest corporate meltdown in history. It was an event followed by a wave of corporate accounting scandals. So many, in fact, that in 2002 Forbes compiled 'The corporate scandal sheet' to keep track of them all [13]. It listed 22 major corporate scandals until they stopped adding names in September of the same year. It was just a taste of what was to come: 2008. Enter the GFC. Money, or the radical loss of it, was a mass public motivator. Corporations and their governance were suddenly a subject of serious attention [14].

THE CORPORATE SCANDAL SHEET

NOVEMBER 2014 • THE BRIEFING ISSUE

Forbes

Snapshots of a Timeline

The New York Times.
BLACK TUESDAY

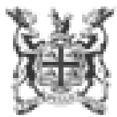
1494

1494 Medici Bank insolvent due to owners profligate spending.

1600 Imperial powers establish chartered co.'s to be held by shareholders.

1602 Dutch East India Co. est.

1670 Hudson's Bay Co. founded. Now worlds oldest commercial corp.



HUDSON'S BAY

1720

1720 South Sea Co. collapses in world's first speculative bubble.

1720 Mississippi Co. collapses after speculative bubble bursts.

1720 UK Bubble Act 1720.

1760 Beginnings of Industrial Revolution.

1776 Wealth of Nations, influences corporation shift from public to private.

1825 UK: Bubble Act repealed.

1844 UK: Joint Stock Companies Act 1844.

1855 UK: Limited Liability Act.

1868 Addition of 14th amendment of the US Constitution.

60%

1929

1929 US: Black Tuesday stock market crash.

1929 Great Depression.

1930s Minamata Bay 36 year release of methylmercury begins.

1945 Japan est. Keiretsu.

1957 Foundation of European Community.

1962 Silent Spring published. Revealing impacts of pesticide.

1966 Monsanto conceals PBC waterway poisons in Alabama [revealed 2012].

1968 14th Amendment added to US Constitution.

1970s DDT identified behind rapid decline of bird populations.

1980s Global reforms: privatisation, trade liberalisation & deregulation.

1984 Bhopal disaster. Poisonous gas from pesticide plant injuring 558,125.

1987 Stock market crash. NZ market - 60% from 1987 peak.

1989 Aus: Qintex $1.5 billion collapse.

1990 UK: Collapse of Polly Peck with £1.3bn in debt.

1991 Swedish Banking Crisis

1991 UK: BCCI forced closure. US: Exxon Corp. Criminal environmental crime. Fine $125 million.

1992 UK: Cadbury Report.

1993 HK: Carrion Group largest collapse in HK history. NZ: COMPANIES ACT 1993.

1995 Barings Bank [est 1762] collapses.

1998 Global Reporting Initiative established. US: Citicorp/ Travellers Group merge in breach of Glass-Steagall Act. OECD releases Principles of Corporate Governance Louisiana Pacific Corp. Issued environmental fine. US$ 37 million.

1999 US: Hoffman-La Roche. Antitrust fine US$500 million Seares Fraud. Fine US$60 million.

2000 2014

2000 Dot-com bubble burst Child labour scandals: Adidas.

2001 US- Enron collapse – loses shareholders US$74 billion.
Chiquita scandals around labour & environmental standards.
Aus: HIH collapse.
Aus: One.Tel –placed under administration.

2002 US: Worldcom collapses after US$3.8 billion in fraud uncovered.
US: Adelphia Communications Directors sentenced to jail for corruption.

2002 US: Tyco scandal – CEO and CFO stole US$150 million.
US: Arthur Anderson convicted for obstruction of justice after
Enron Bre-X mining fraud.
US: Xerox accounting fraud revealed.
Global Reporting Initiative est.

2003 US: Freddie Mac scandal.
Italy: Parmalat scandal. US$14 billion black hole discovered in finances.

2004 US: Fannie Mae scandal.
EU: Action plan on corp. governance released.
US: El Paso Electric causes blackouts to inflate prices in California.
Royal Dutch Shell reserves scandal.
NZ: Governance Principles and Guidelines.

GFC

2007 NZ: Bridgecorp, Capital + Merchant and Nathans Finance all into receivership.

2008 Global: Financial Crisis.
Société Générale reveals rogue trader losses at €4.9 billion approx.
US: Lehman Brothers bankrupt.
US: Bernie Madoff revealed as tricking investors out of US$64.8 billion.
NZ: Hanover and Lombard Finance failures.
India: Satyam falsely boosts revenue by US$1.5 billion.
China: Sanlu charged for adding toxic chemical to baby milk powder.
UK: Bear Stearns Investment Bank sub-prime collapse.
UK: Northern Rock subprime crisis & first bank run in 150 years.
Scotland: RBS insolvent.

2009 Gulf of Mexico oil disaster. BP guilty gross negligence & wilful misconduct.

2010 US: SEC fines Goldman Sachs $500 million for incomplete information.
NZ: South Canterbury Finance collapse triggers $1.6 million bailout.
Pike River Mine disaster.

2011 News of the World phone hacking scandal breaks.

2012 Libor scandal breaks: Major banks and auditors fined US$6 billion for fraud.

2013 Bangladesh factory collapse caused by cost cutting.
GlaxoSmithKline China bribery scandal.
European horse meat fraud scandal.

2014 Samsung faces new child labour charges.
PwC fined US$25 million for aiding terrorist state money laundering.
Luxembourg tax scandal breaks. 350 international companies involved.

A real timeline would require a whole book to document all the events on records.
This one simply sets out some of the more notable.

SELF-REGULATION REQUIRES A CONSCIENCE.

"Self-regulation requires a conscience. Corporations are the engines of capitalism. Wherein lies the conscience of the corporation – an inanimate, legal construct devised by man? That is the question at the heart of corporate governance. Does it lie in the board, which society should trust to ensure that the corporation causes no harm? If so, is the board equipped with the moral precepts, intellectual ideas and norms of conduct that will enable it to discharge its responsibility to society? The responsibility of the chairman of the board is to ensure that the board is so equipped. A capable board with a conscience can ensure that the corporation's executive management is well equipped to act responsibly too."

Arun MaiRa.
Former India Chair,
Boston Consulting
Group

Challenges within the model: Problems and opportunities

So here we are, in a world where incorporated entities have legal rights and liabilities that are distinct from their employees, shareholders or members; having, ostensibly, the status of a person. It is reasonable to enquire then, what sort of 'person' is the corporation?

A Canadian documentary tackled exactly this question when the makers conducted an extensive review of corporate history and mapped the corporate personality type against standard mental heath diagnostic criteria. The history they set out revealed a problem of considerable scale: deliberate fraud, lies, theft and endless successions of business cover-ups, which have affected the lives of millions of people – all on record. Their diagnosis? Psychopathic [6].

- Evidence of a callous disregard for the feelings of other people? Tick.
- Incapacity to maintain relationships? Tick.
- Reckless disregard for the safety of others? Tick.
- Deceitfulness (continual lying to deceive for profit)? Tick.
- Incapacity to experience guilt? Tick.
- Failure to conform to social norms and respect the law? Again, tick.

If this were a person being assessed, the ticks to all these boxes would produce a diagnosis of a pretty serious disorder.

As research identifies, the problematic social impacts of corporations are not found only in the economic failures touched on in the previous chapter. There are multiple industry examples of health and environmental failures: petrochemical disasters, tobacco health cover-ups, avoidable drug deaths, environmental and human harms through agrochemicals, appalling levels of pollution through paper and pulp; it seems it's hard to find an innocent space. So many processes of manufacture and supply are now recognised as responsible for major economic, environmental or health problems. Yet, as research shows, as many times as problems have been recognised they have also consistently been played down, covered up or trivialised by the companies involved – all in pursuit of profit [13]. A regular pattern seems to exist where corporations have known about potential harms or deliberately chosen not to set up proper human and environmental safeguards, and then stubbornly refused to enact change until the information becomes too overwhelming to ignore and they're forced into transformation.

Of course, not every board runs badly. Many are fine. Some are exceptionally good. But over time bad seems to have multiplied and the scale of the social and environmental impacts seems to be getting larger. The level of problem was finally acknowledged in the 1990s after a series of resounding failures affected investors' confidence in the power of executives to run a business effectively [14]. In particular, the infamous and dramatic disappearance of Jan Ludvik Hoch from his yacht in the Canary Islands on November 5, 1991 captured headlines and fuelled public anger [15]. Hoch, better known as Robert Maxwell, had simply vanished, as had the assets from the employee pension funds of the companies he operated. In 1992, as a result of this very public situation, the UK formed the Committee on the Financial Aspects of Corporate Governance to develop a view on what might be done. The result was what came to be known as 'The Cadbury Report' (Sir Adrian Cadbury being head of the committee). In the report the committee voiced its concerns with current models of corporate governance and set out a framework for improving effectiveness [16].

The Cadbury Report: Code Principles

The principles on which the Code is based are those of openness, integrity and accountability. They go together.

Openness on the part of companies, within the limits set by their competitive position, is the basis for the confidence that needs to exist between business and all those who have a stake in its success. An open approach to the disclosure of information contributes to the efficient working of the market economy, prompts boards to take effective action and allows shareholders and others to scrutinise companies more thoroughly.

Integrity means both straightforward dealing and completeness. What is required of financial reporting is that it should be honest and that it should present a balanced picture of the state of the company's affairs. The integrity of reports depends on the integrity of those who prepare and present them. Boards of directors are accountable to their shareholders and both have to play their part in making that accountability effective. Boards of directors need to do so through the quality of the information, which they provide to shareholders, and shareholders through their willingness to exercise their responsibilities as owners [16].

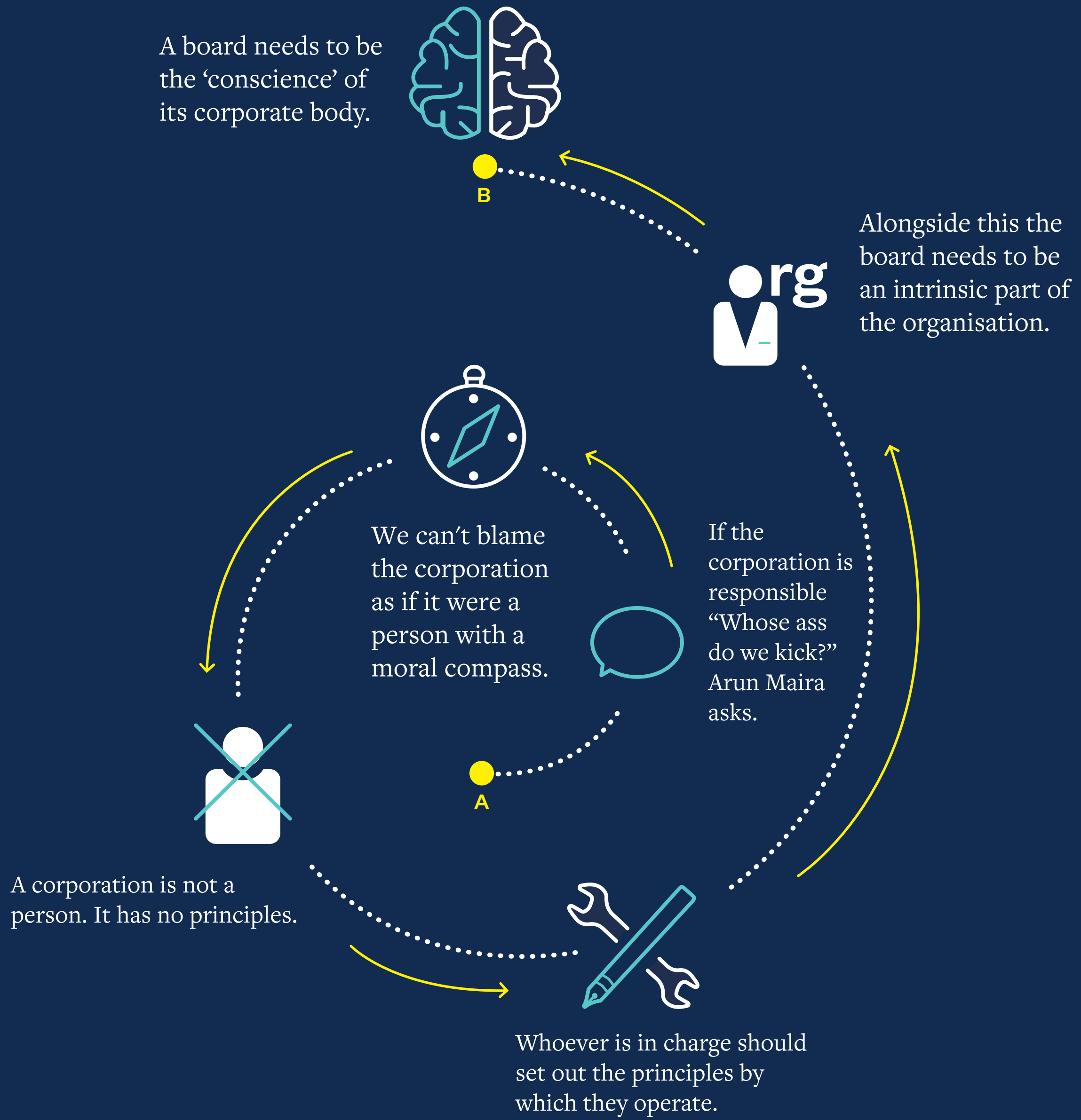
The conclusion? Good governance requires proper principles. The committee's directive was to focus on money, but it was the Code of Best Practice it delivered that got wider attention. Succinct and to the point, barely two pages long, it set out a clear framework for boards. It also observed that alongside the need for principles, current models lacked teeth when it came to setting up effective ways to provide oversight, checks and balances to corporate decision-making. The report also made some specific recommendations: separate the role of Chief Executive Officer and Chairman, use non-executive directors (NEDs), and recognise the desirability of independence and the appointment of NEDs to an audit committee of boards of directors. What it was proposing were not unheard-of solutions. In fact, they reflected ideas behind many European practices [15]. Timing is everything. Thanks to very public failures the wider world was now asking questions and this answer was clear and simply stated: good governance requires good principles to drive it.

Despite its UK origins this became a globally important document, now considered part of the genesis of contemporary corporate governance. It has been used to inform development of frameworks in over 28 countries [15, 17]. But despite all this global enthusiasm for the work, it is now over 20 years old and we are still seeing the same old problems. Why?

The need for the 'human in the machine'

If the corporation is responsible when it all goes wrong, and not the individual, as governance expert Arun Maira asks: "Whose ass do we kick?" [18]. Legally, we have recognised the corporation as if it were a person. But we cannot blame the corporation as if it were a person with a moral compass when things go awry. It has been efficiently designed as a vehicle to serve a specific purpose. It is not a person. It has no principles. Governance is also inherently neutral; it becomes shaped by the people involved. What The Cadbury Report pointed to is the need to recognise that whoever is actually in charge should actively consider and set out the principles by which they operate. Alongside this the board needs to be recognised as an intrinsic part of the organisation – of it, not separate from it. As such, a board needs to cultivate its role as the deliberately developed 'conscience' of its corporate body.

Human in the machine



> "For illegality and immorality to occur all that is needed is a weak or nonexistent conscience, secrecy and an opportunity for illicit gain. A weak conscience allows one to act contrary to basic moral values and to violate core laws and secrecy makes getting away with one's criminality more likely. It follows that to eliminate or limit one these preconditions for immoral/illegal actions would greatly reduce the scope of corporate crime."

– Joseph Grcic, Philosopher

The problem of conscience

A conscience is a moral sense of right and wrong, a guide to behaviour. It is not innate but formed through the society in which we live, by processes of socialisation. It is realised as an individual internalises the customs, beliefs and moral 'rules' of his or her community and society, as taught by parents, teachers, peers, media texts and other key social influences. This constellation of 'norms' absorbed by one person constitutes individual reflection of wider social beliefs about what will preserve and promote the 'common good'.

Having a conscience does not mean someone is morally flawless. The conscience as product of the socialisation of the society from which we come can also be shaped by a system where the moral structure is far from perfect (think Enron). What is required to optimise a corporation's moral behaviour is to deliberately develop it from a wider environment of cultural values, beyond profit and addressing the entire community of stakeholders it affects. It is this wider community-shaped version of conscience that keeps people in check. Law alone could never contain an individual, let alone a group or entire community.

So what if the beliefs and values of the community are a problem, such as with the origins of the GFC? Conscience needs to be quite deliberate and subject to ongoing critical reflection if it is to expose any problematic beliefs, values or actions. This form of conscience can be described as 'well-formed' and because it is mindful it's generally better able to control selfish and immoral tendencies and promote (or at least not grossly violate) the common good.

To create a structural equivalent of a well-formed conscience in a corporation is to establish a form of governance that can produce the same results: principle-driven, diverse, deliberately reflecting on values and assessing practices – so what constitutes the 'common good' can be clearly identified and set up to guide and be accountable for actions. This means installing directors who understand and represent the mix of internal and external concerns that constitute an agreed common good, ideally in equitable participation.

The complexity within the idea of the corporation as a person and the board as its conscience is that choices and actions are (usually) arrived at by a number of people. They are the result of a set of group processes. Effective decision-making in a corporate setting therefore requires both a strong and well-understood set of principles and a good awareness of how the most effective process of selecting alternatives works in a group environment.

This requires investment in people with specific skills or potential investment in up-skilling people already in place.

The corporate entity cannot be a 'whole' person unless it has a properly skilled and functional board with a strong ethical compass and a set of irreducible principles that guide what the board and the business does through multiple iterations.

To function well, corporate conscience needs to be not just well-formed, but well-informed.

The problem of asymmetrical knowledge

Research into boards and the worlds of directors identifies a sense of serious frustration [19]. Governance is under more intense scrutiny than ever before but directors and executives are still struggling to work out the right balance of roles and inputs to execute fiduciary and shareholder responsibilities while continuing to move the organisation forward.

In terms of inputs an acknowledged problem is information flow. The knowledge and information the directors have is usually incomplete and this puts the employee in a superior knowledge position to the board [20]; it certainly leaves directors vulnerable. Under-reporting or over-reporting can both lead to lack of clarity or critical knowledge gaps. While actual fraud is, in reality, a less common problem for boards, sanitised reporting and deliberate attempts to cast the best interpretative light on performance are a pervasive problem in business culture, for boards and senior executives.

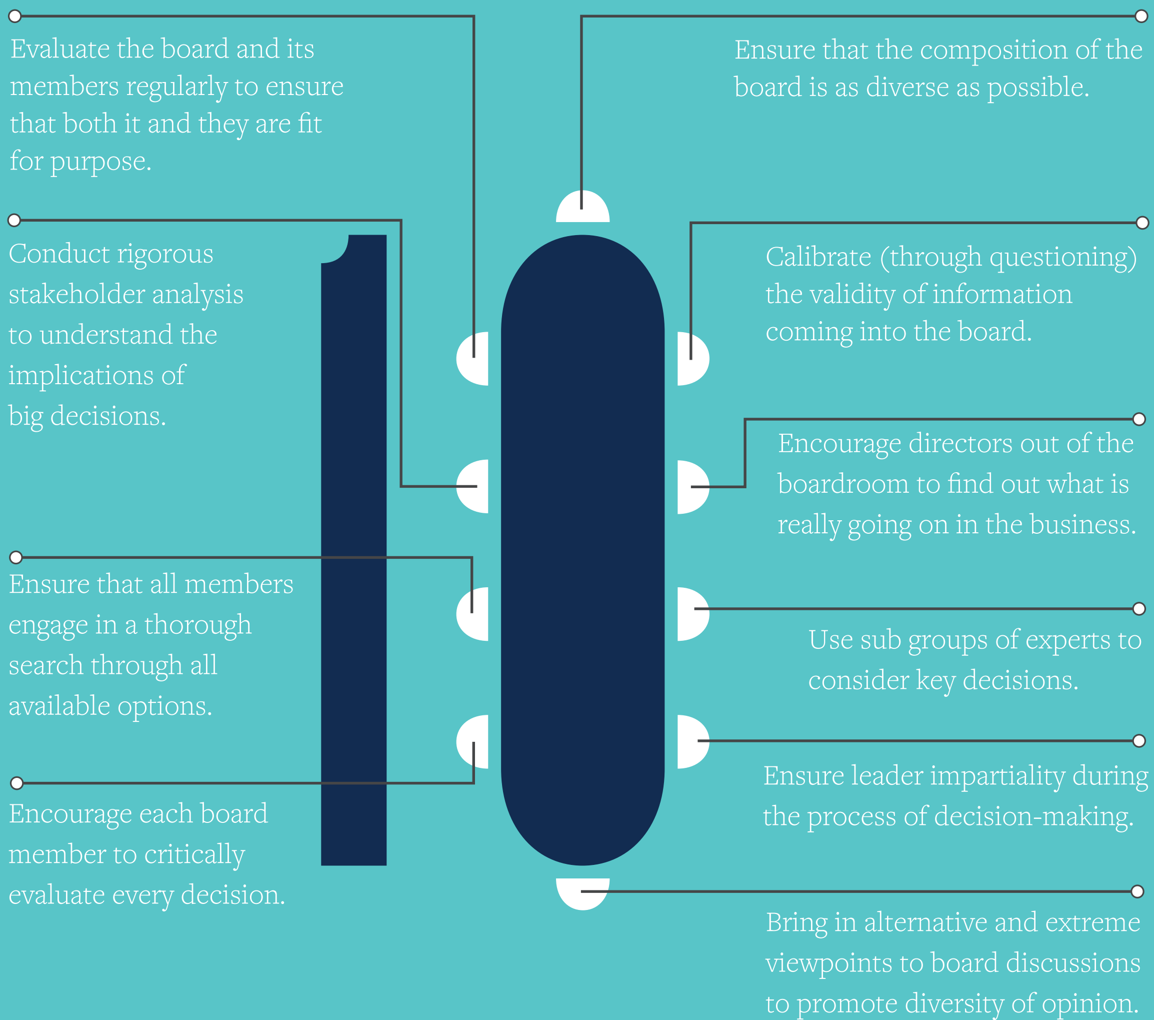
The path to mitigating these sorts of effects is a mix of culture and process. The board sets the tone for the organisation and it is its role to cultivate an environment of trust that encourages frankness and learning, and recognition of the benefits of a true picture of performance. It also helps to encourage publicity and transparency of decisions and actions through the business. In addition, any organisation needs well-developed flows of information and easily read dashboards of progress – financial and otherwise.

The problem with regulation

The common argument in response to crisis is for a fresh regulatory response. There is a logic behind this view that commentators argue needs examination [22, 23]. The reasoning goes like this: In a free market capitalist system, the directors and executives of an organisation are the employees of the shareholders and their only responsibility is to increase profits, within the parameters of the law, which is the reason shareholders invested in the business to begin with. To take into account the need for social responsibility beyond what the law immediately requires (e.g. reducing pollution or hiring to a policy of diversity rather than employing the most qualified) would be inefficient, reduce the profits of the company and thus harm the shareholders. In this framework, it is the job of government – not of business – to be proactively responsible and protective of the greater good. To suggest corporations might be socially responsible over and above what the law demands is to ask more than is reasonable – seen by some as a slippery slope towards an overly left-wing agenda.

In fact, legal obligations are to the company not shareholders. Setting this aside however, we rely on law to address failures of governance, what is the outcome? Law is by definition a reaction to a problem that has already occurred and so will always allow certain immoral actions to occur until legislature is enacted to make such actions illegal. In addition, law is usually negative in formulation, telling us what not to do. However, social good and conscience or 'moral' behaviour does not just involve the avoidance of evil, but the promotion of good, at least to some degree.

Ten Top Tips for Effective Board Level Decision-Making



Developed by Norman Broadbent [21]from their selected references:

- Baron, J. (1992). Thinking and Deciding. New York: Cambridge University Press
- Dunne, P. (2005). Running Board Meetings. London: Kogan Page
- Janis, I.L. (1982) Groupthink. Boston: Houghton Mifflin Harcourt
- West, M. (2004) Effective Teamwork. Leicester: BPS Blackwell

Also, if we rely on external bodies to regulate the actions of groups, we always risk what is known as 'regulatory capture'. This exists when government agencies that are set up to regulate organisations in the public interest are then improperly influenced by the very industry they are designed to control. Post-GFC the New York Federal Reserve (now the chief U.S. bank regulator), commissioned a study of itself in order to understand why it had not spotted the destructive behaviour inside the big banks and stopped it before it got out of control. The nub of the outcome? The Fed failed to regulate banks because it did not encourage employees to ask questions, speak their minds or point out problems – in fact quite the opposite: The Fed was found to encourage employees to keep their heads down, obey their managers and appease the banks. That is, the regulators failed to do their jobs, not because they lacked the tools but "because they were discouraged from using them" [24]. Despite this it seems that things have not changed. A recent scandal emerged following the release of the Segarra Tapes: 46 hours of tape recordings made secretly by a Federal Reserve employee, of conversations within the Fed and between the Fed and Goldman Sachs [25]. They make it clear that regulatory capture remains a serious problem.

It is abundantly clear that those in positions of governance are not always adequately motivated to act legally or morally. The legal system does not and cannot provide sufficient penalties to act as a deterrent [23]. In addition, in today's global economy complex bureaucracy and ownership structures can provide a shield of anonymity. The anonymity problem is exacerbated by the problem of secrecy, which illegal actions require. Regulation has been the repeated response to crises of governance [17]. It is clearly not working. As has been identified already, law cannot contain the behaviours of a person or a community; it is conscience and principles that are required – to which law is a supplement. Of course, regulation can contain carrots as well as sticks to motivate ethical conduct.

The wider socio-cultural context is seeing a more vocal public demand for corporate responsibility towards social and environmental impacts. Some influential voices have recognised that meeting this expectation is necessary for the ongoing success of the business [17, 22, 26]. Stakeholder theory is one way into the paradigm. Proponents of it argue that if you focus just on financers you actually miss what makes the heart of capitalism beat, which is that shareholders, financiers, employees, suppliers and communities can together create something that no one of them can create alone. The single focus on shareholders and profits is argued as misleading and ultimately destined for failure [27].

Increasingly, the attitude is that attention to wider interests will serve the shareholder if a longer-term view is taken. Perhaps the most epic example of why is the BP Deepwater Horizon tragedy in the Gulf of Mexico in 2010, which led to loss of life and the destruction of the gulf ecosystem. The National Commission report into the accident traced the problem to multiple decisions by BP employees and contractors to ignore standard safety procedures in attempts to cut costs [8]. At the time of the disaster the project was US$60 million over budget and costs were rising at US$1 million per day. The final cost to shareholders after the event was a decline in total market value of nearly US$100 billion.

The cost of doing business through the subsequent impact on resources will potentially be globally catastrophic in the longer term if we continue at the present rate [28]. Because the existing model

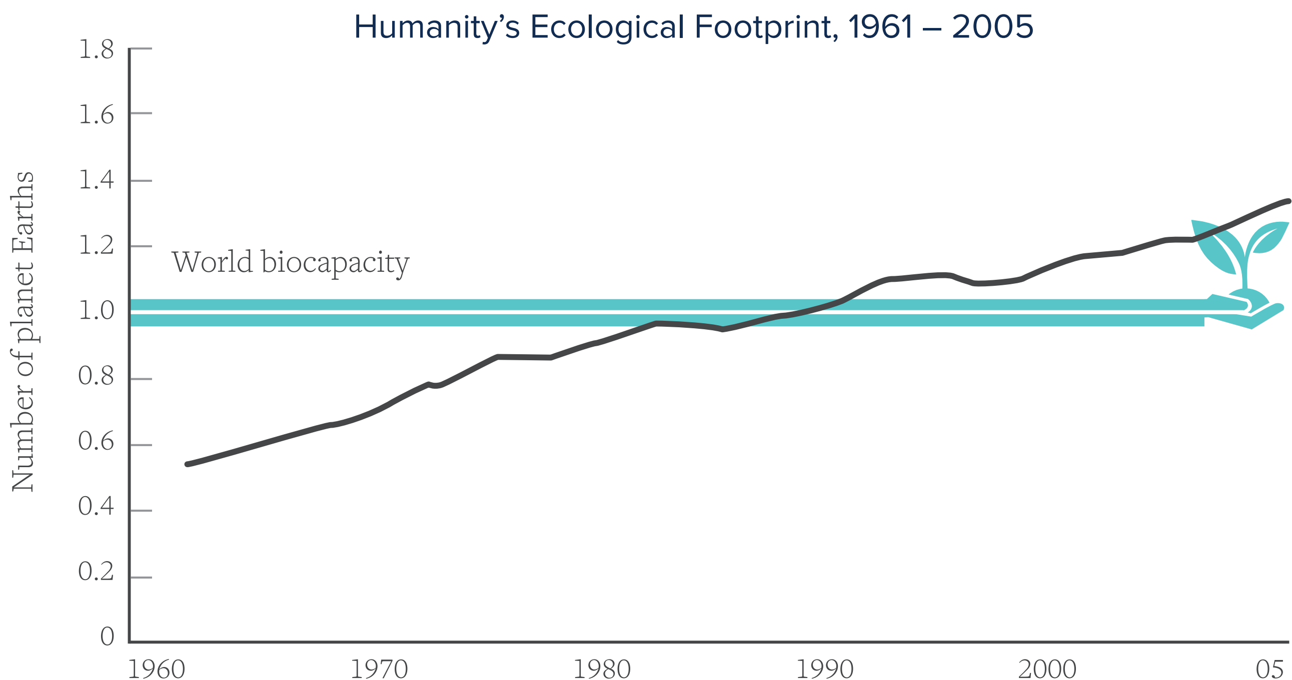
has been so narrowly focused on short-term returns and the business as a separate entity (as opposed to a functioning part of a social system) the long-term horizon and wider impact has had insufficient attention. The opportunity is in cultural relocation and considering a different form of accountability.

Problems of accountability

Scholar Raj Patel argues that the real cost of a McDonald's Big Mac in the US should be US$200 [29], if you take into account that:

- The production of Big Macs in the US every year results in a greenhouse gas footprint of 2.66 billion pounds of CO2 (US$297 million)
- Costs of corn feed subsidies, courtesy of the common taxpayer, are at around US$4.6 billion
- Costs from "social subsidy" in the form of welfare offered to minimum wage fast-food workers are at US$273 million
- Public health costs due to diet-related diseases from excessive meat consumption are around US$30-60 billion

Though one can readily dispute the absolute veracity of Patel's figures, he makes an important point about authentic accounting and 'proper' accountability. We can buy a Big Mac at a surprisingly low price because the business is not (yet) accountable for the true price of the product: the environmental and social costs of its production and consumption. Who does pay the bill on these expenses? It is the taxpayer of the country in which the costs are felt. This realisation is reasonably recent but it is growing. It seems highly likely that there will soon be demands for some form of accountability from the originators of such costs. The ecological debt incurred by rich countries to poor between 1961 and 2000 has been estimated as over US$4.3 trillion – a number nearly two and a half times the debt owed by poor countries to rich nations [30].



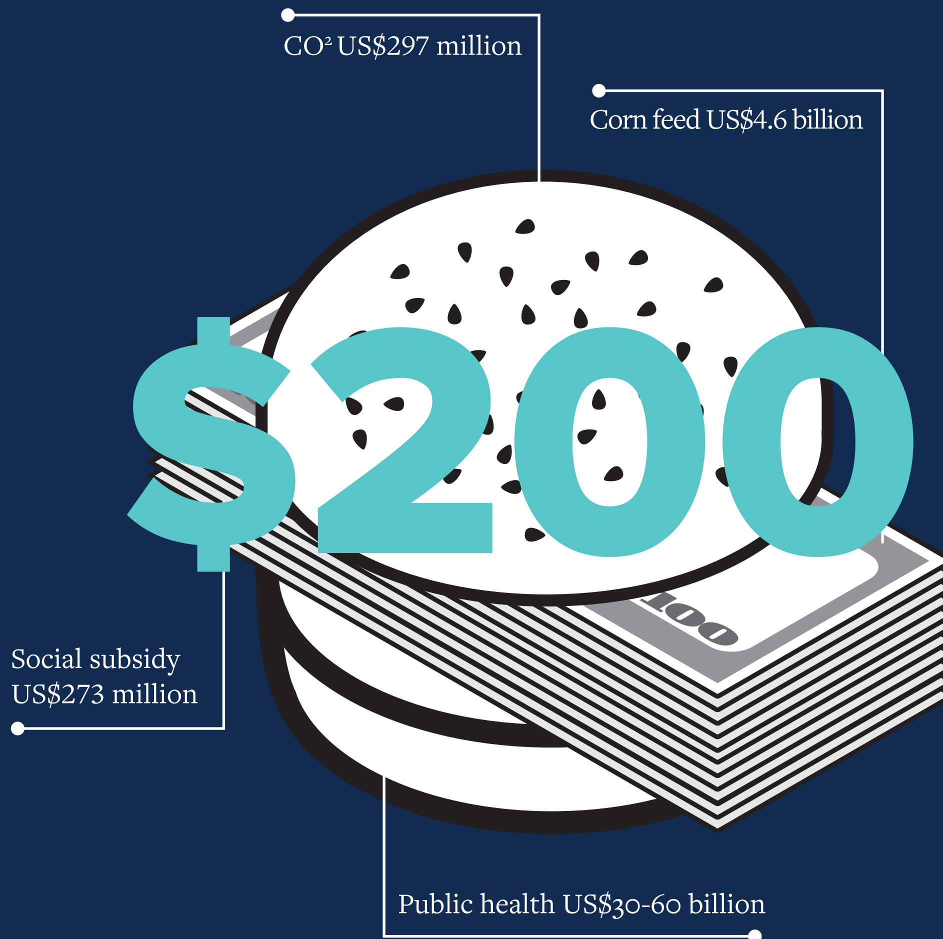
The problem is, the accounting systems we use in business evolved when natural resources seemed limitless and the focus of those in governance roles was on managing the industrial revolution and growth of industry, not the environment. Yet the things we need most to survive – such as pollution-free spaces, safe water, live forests and healthy coasts – are not accounted for, and as we now know, this is a problem. With environmental sustainability one of the major challenges of our age, it is hard to see how social and environmental capital can be left off the company books for much longer. The challenge is how to include these complex things on the ledger manageably as they can seem nebulous and difficult to measure.

Significant work is underway to tackle this challenge, some using frameworks based on value creation as opposed to resource burden, with The Integrated Reporting Initiative being one of these.

Another European project (The Global Reporting Initiative) has developed very specific measures of sustainable value that integrate environmental and social dimensions into analysis and therefore into decision-making. The results of their analysis across sectors show considerable differences in performance and identify specific measures that would produce improvements. While the work has limitations, as it only assesses quantifiable elements, it is an interesting start [32].

Social cost of business has also been raised post the GFC. Governments have presented their tax-paying citizens with the bill for this event, while businesses implicated in the cost of its creation have continued to function with the same boards and the same frameworks of governance. This has also created calls for investigation and change [22]. It may be helpful to examine the narrative about what went wrong.

Counting the Costs



The narrative problem

Stories about ‘how things are’ represent powerful normalising mechanisms that can obscure alternatives. The current narrative around corporate failure in media commentary often looks for “heads on a plate”– unethical directors or managers who can be blamed for catastrophe – what the commentators in US media repeatedly call “just a few bad apples”. However, as the title of one examination of financial failure suggests – ‘Jérôme Kerviel the ‘Rogue Trader’ of Société Générale: Bad Luck, Bad Apple, Bad Tree or Bad Orchard?’ – it may be the orchard, not the apple, that’s the problem [33]. If the orchard is the issue then no matter how good any board looks right now the long-term prognosis may not be so rosy.

Apple: Proposes an individual effect like that argued as created by Alan Hubbard of South Canterbury Finance.

Tree: Proposes a culture that facilitates poor behaviour such as Enron or Barings Bank, or more widely to an industry culture, such as argued in financial institutions involved in creating conditions for the GFC.

Orchard: Proposes the model is the problem because it is too narrow and lacks the ability to recognise longer-term social or environmental impacts that will affect the sustainability of the business and wider communities.

Clearly all three things can be true, but it is the last that has the most significant implications for all involved.

Effective Board Behaviours

Groupthink Behaviours

Every board member is encouraged to be a critical evaluator and given space to express views

The leader maintains a neutral status and uses a facilitative style

Board members guard against wishful thinking based on insubstantial rationalisations and if in doubt seek additional data

The board conducts a thorough stakeholder analysis to understand the wider context and the implications of decisions

The board undertakes a systematic search through all the available options

The board is more concerned with suppression of dissent than quality of decision-making

The board is ruled by a directive leader who makes his/her wishes known

The board rationalises and discounts warnings based on a selective approach to information gathering

Outgroups – such as partners or competitors – are stereotyped as weak or stupid

Board members choose the first option for solution on which there is a consensus

Problems of drivers

In any organisation there will be different drivers motivating participation, choices and actions. Governance in the hands of aligned interests can be as much of a problem as when interests are too divergent. In a cooperative, for example, interest of members will often be highly aligned. This can lead to a form of 'groupthink' that can threaten the ongoing sustainability of the business. Independent Executive Directors are a potentially crucial tool for effectiveness against such problems.

Another potential setting for driver conflict is when the role of the Chair and the CEO are not separated [23]. Separating these roles remains an ongoing debate in corporate governance. The issue centres on whether a potential conflict of interest exists when the roles are combined and whether there is an appropriate balance of power between the CEO and the independent board members. To have the roles combined creates a significant concentration of autonomy with less opportunity for the objectivity and guidance a good independent Chair can bring.

As of 2012, only 43 per cent of the S&P 500 boards currently separate the roles. But there is a definite mood for change on this [34].

A growing majority of shareholders are institutional and this group is becoming far more active in governance [22]. This can see quite different sets of drivers in play, which will have significant impact on the business pathway. On one side the investor focus can be very concentrated on short-term profitability. Directors and executives argue that this creates a significant and problematic pressure for business to focus on delivering immediate returns over any investment in future needs. Investors with a view to long-term viability argue the problem for them can be the executive whose position is rewarded for short-term horizons and for taking adverse levels of risk [22]. The practice of tying executive incentive to profits when tenure is five years on average is certainly likely to produce a focus on more immediate profits [35]. Independence of directors is a vital counter to these conflicts and to ensure a drive to effectively manage short and long-term interests in order to deliver ongoing sustainability.

The problem of the new world order

Historically, organisations have largely been able to get on with their day-to-day activities without too much interference. But things have changed. The world is clearly taking more notice of the relationship between business, community and environment. As the next decade unfolds every business is likely to be given attention. The general public in all nations is becoming increasingly politicised and engaged, whether around cost of supply in terms of resources used by organisations and the impacts of their activities, or by actions of executives. Increasing efforts are underway to 'out' businesses that are seen to fail in any of their social, cultural or environmental obligations. The person in the street, village or wilderness is becoming more aware and (potentially) more principled. As organisational impacts become more pervasive and affect more people, such as with large negative environmental or health outcomes, the wider world will be a primary voice of demand for a change in governance model by any organisation not deemed to be delivering 'good' governance.

> The current political system is still under the dominant influence of the entrenched economic elite and more radical campaign reform and the right to political leave is necessary before legislative enactments would perform the necessary social functions of controlling corporate actions. Moreover with the growing global economy and the multinationals, legal control of corporate entities which can flee to any part of the world to find cheap labor and corrupt governments is becoming increasingly difficult.
>
> – Joseph Grcic, Philosopher

What does good look like?
A potential way forward

Assessing the model: A framework for progress

In this era of capital mobility and globalisation, effective governance is becoming acknowledged as an important framework condition affecting the competitiveness of countries as well as corporates [36]. As has been identified there are many different definitions and models for what this looks like around the world, which differ according to the variety of capitalism and/or culture in which they are embedded. There is growing recognition that models focused on short-term gains that lack consideration of wider impacts are no longer adequate in the contemporary context and that a more holistic, principle-driven framework can improve outcomes [22, 26, 37]. In addition, the need for some form of common approach is increasingly acknowledged as necessary as global boundaries blur and questions of whose laws, whose borders and whose real costs are progressively raised.

Guidelines and frameworks that answer the need for a wider, principled model of governance are gaining momentum and attention [22, 26, 32, 37-39]. European organisations have been particularly active in engaging in stakeholder dialogue, extending producer responsibility for products, and adopting more inclusive forms of corporate governance. There is also a movement in some parts of the business community to attempt to engage in processes of cross-sector collaboration and to initiate wider stakeholder dialogues, particularly in companies with offices in developing nations [37]. There is a simultaneous trend to quantify social and environmental impacts in order to make them less nebulous and offer rigour to frameworks of assessment and accountability that can make them more accessible to businesses. Organisations like the Global Reporting Initiative (GRI) [32], as an example, now offer comprehensive guidelines and principles that companies can take up and report to on the economic, environmental and social impacts of their everyday activities. However, it must be acknowledged that frameworks like the GRI's – despite claims to being suitable for any size of organisation – can feel quite complex and overly heavy on detail. A simpler framework and a compelling anchoring idea about the benefits of this shift to business interests is probably needed to support wider engagement and uptake.

Michael Porter, most famous for his Five Forces Model [40], has one answer. He argues for a shift to a model of Shared Value [26]. The concept is simple enough: defined as a business having policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. It might sound like corporate social responsibility (CSR) but it is an idea that deliberately moves beyond CSR, seeing that as a peripheral focus, to describe corporate shared value (CSV) and to locate it as a central focus.

What Porter and his colleague Mark Kramer highlight in their work on CSV is the need to locate focus and responsibility for whatever framework that is taken up as a core concern of governance. This can give opportunity for teeth to be developed for the model, making it a tool for genuine change and ongoing improvement as opposed to being a fresh set of peripheral activities to tick off for monitoring purposes (usually put into the hands of a manager with 'responsibility' but no actual ability to enact the systemic alterations required to make a difference). They are arguing for genuine change. What is required for that to happen is for boards to engage.

The accessibility and simplicity their model describes can help that happen. Overly worthy attempts to unpack a stakeholder view, CSR or CSV into high levels of detail and demanding processes are fated to fail. What will have greater hope of success are simple sets of principles and pragmatic methods of assessment that can be adapted and embedded into the heart of an organisation's culture and operations. The point remains that the model on offer needs to be championed and accepted by the people involved in governing it.

> “Companies that have grasped the importance of actively developing and sustaining relationships with affected communities and other stakeholders throughout the life of their project, and not simply during the initial feasibility and assessment phase, are reaping the benefits of improved risk management and better outcomes on the ground.”

– International Finance Corporation

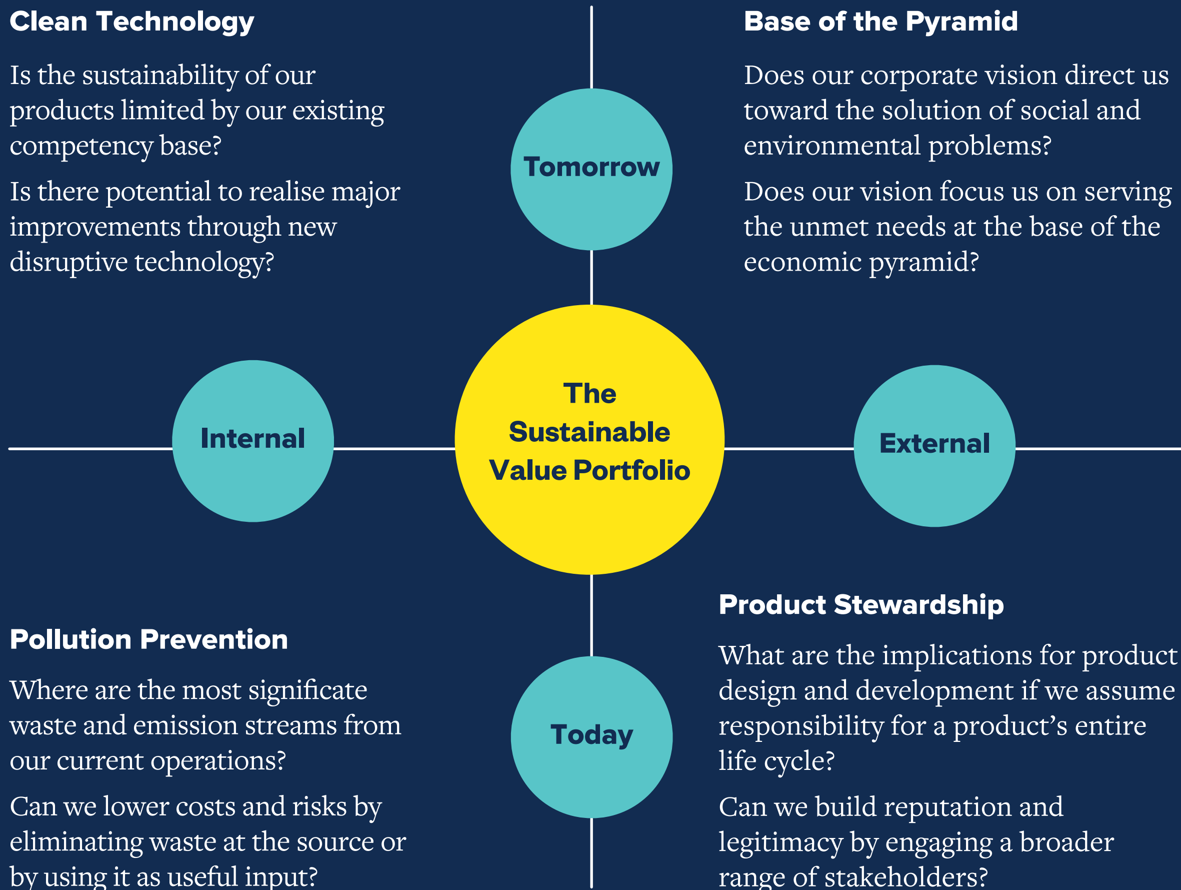
If shared value seems a little too close to the slippery slope warned of by Friedman, then perhaps a more compelling terminology for business is Sustainable Value. There is more than one version of this idea and which one does matter. Sustainable Value can be understood as a variant on Porter's view – as something a business looks to achieve within its existing activities – addressing objectives around minimisation of resource consumption and production waste, fostering employee and community wellbeing and addressing any social burden caused by a firm's portfolio of activities.

A second model for Sustainable Value has emerged over the past decade from Stuart Hart and Mark Milstein [38]. They have developed a framework that directly links the challenges of global sustainability to the ongoing creation of shareholder value by an organisation, looking specifically at business opportunities in targeting social issues like illiteracy, poverty, hunger, or inadequate access to social services. This model offers an interesting proposition in the reworking of the products, service and community development elements of models like Porter's, to focus on the business opportunities that exist in innovation in servicing the fundamental needs of society [41]. If the idea seems difficult to grasp immediately, the GE case study reported here makes the gains tangible. The potential challenge is that if you are constantly looking at community need as a source of profit, you are in danger of compromising the move away from pure profit. Perhaps a different solution is to take Porter's approach but to use more accessible language. Developing a model of sustainable value for a business through policies and practices that enhance competitiveness while simultaneously advancing the economic and social conditions in the communities in which it operates; if that can include innovations to improve the social good then so much the better.

In the end, the answer to good governance when it comes to the model is to recognise and assess the existing model by which your organisation is shaped. If it is lacking any articulation of principles, if it is too narrow, too inward-looking, or too focused on profits in the short-term then best practice suggests looking at how to create some changes.

In the case of a small business, as one author writes: "...ethical operations are not just for the Fortune 500" [42]. Small businesses can become large ones and having a good set of guiding principles from the start can mean fewer growing pains later. Even a start-up can set out with governance guidelines that encourage integrity and accountability going forward and make the business more attractive to investors in due course. While you may not need a larger board of directors, an independent director or an advisory group are recommended mechanisms to achieve many of the same benefits of objectivity, advice and guidance for the business.

Questions of Sustainable Value



GE: Turning Customer Feedback into Business Opportunities

Customers call for a focus on the environment.

GE's path to Sustainable Value Creation began with mobilizing the company to tackle environmental issues, not only by optimizing the efficiency of the firm's own operations, but by creating a product portfolio that delivered solutions to environmental challenges. How did environmental concerns rise to the top of the company's shortlist of issues? Focus-group sessions with customers revealed widespread concern regarding government regulations and rising oil prices. Picking up on this theme, GE's Chairman and CEO Jeff Immelt saw an opportunity for a win-win strategy: to improve the environment and the bottom line by filling this growing market need with next-generation jet engines, power turbines, locomotives, water-treatment systems, solar panels, and other solutions.

Reconciling competing customer and employee visions.

Launched in 2006, the now-famous ecomagination program has been a roaring success; the company sold more than $18 billion worth of ecomagination products in 2009 and expects that figure will double by 2015. However, at the time of ecomagination's launch, GE employees were highly skeptical that the billions being invested in R&D would pay dividends—they dismissed the initiative as a marketing gimmick. In fact, at first Mr. Immelt and SVP and CMO Beth Comstock were the only believers. Referring to the firm's employee base, Mr. Immelt famously said to a journalist: "It was like two people against 300,000 the first day." Mr. Immelt and Ms. Comstock combated that resistance by linking employees directly to customers and emphasising the energy savings and market successes along the way.

A move from environmental to societal issues.

The next phase in GE's Sustainable Value Creation journey directly leveraged the lessons learned and employee acceptance gained through the ecomagination project. Again, GE developed a shortlist of issues by connecting more deeply with customers to understand their concerns. This active listening led to the company's next opportunity: consumer health. As with ecomagination, the company followed up on customer feedback by dispatching teams to assess the market, audit the company's current product portfolio and research technology trends. The company identified needs in four major areas: health reform, technology, health delivery, and consumerism and primary care. Thus, healthymagination was born: a six-year, $6 billion commitment to health-care innovation designed to deliver better care to more people at lower cost, all while growing GE's business.

> “It’s about using the scale of GE, the majesty of the company, to drive growth and change.”

– Jeff Immelt, Chairman and CEO, GE

Taking a long-term approach to innovation.

Asked in a December 2010 New York Times article to reflect on his philosophy, Mr. Immelt described himself as a champion of "large-scale entrepreneurship," meaning that the company identifies long-term market shifts and then marshals its research, manufacturing, and marketing resources to capitalize on the opportunity. Summarizing his approach, Mr. Immelt said: "It's about using the scale of GE, the majesty of the company, to drive growth and change."

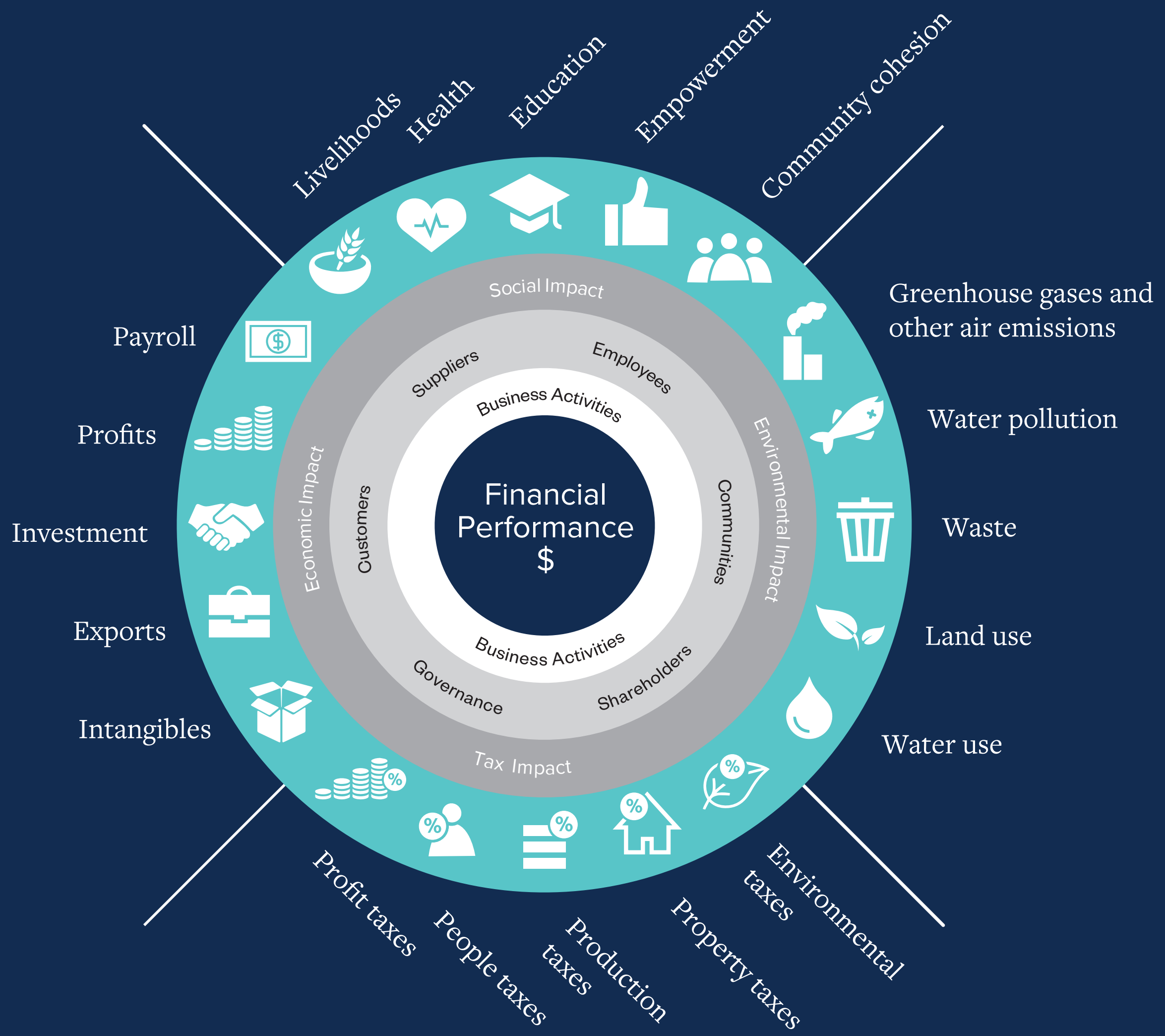
A principle-based model.

There are many possible frameworks on which a company can draw to assess and develop the model of governance being used today. The framework below is an example selected for its simplicity. It comes from the Canadian Institute of Corporate Directors. It summarises neatly all the key points addressed in the previous discussions to set out a straightforward, principle-based approach for governance that can be applied to an organisation of any size.

To unpack the complexity of what is nested inside the Service & Fairness area requires a more comprehensive impact assessment framework. The model to the right, taken from the work of PwC, is again selected for its simplicity and accessibility. They have broken organisational impacts into key quadrants: Social, Environmental, Economic and Tax.

A Principle Based Framework

An Impact Assessment Framework



Putting the human into the machine: Creating high performance

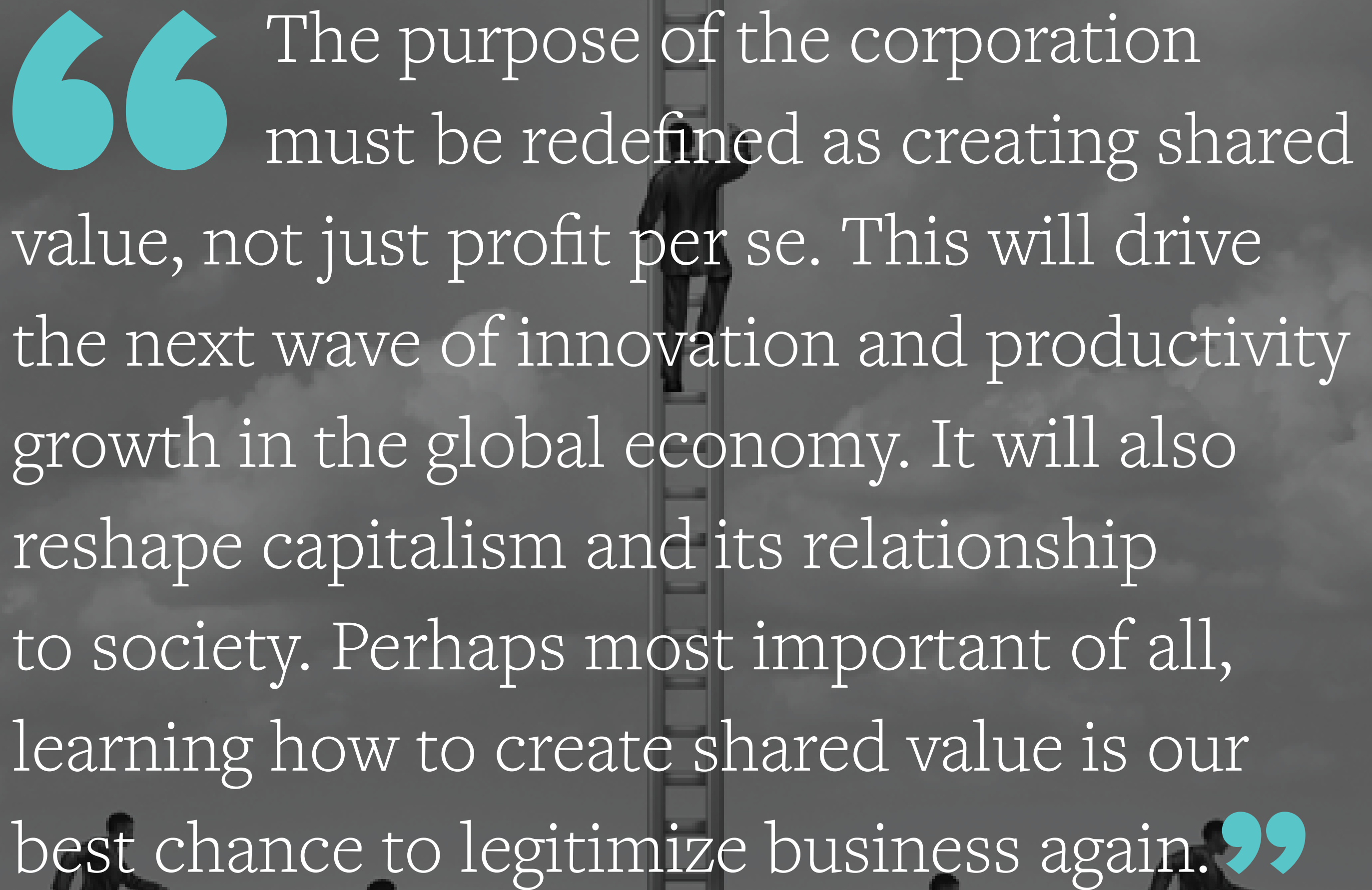
Board performance is taking centre stage in the global governance conversation with scrutiny now on key areas of effectiveness and balance of activities, skills of members and composition/ diversity of the board. While it is widely agreed that high performing boards need the right mix of people and skills, the composition of many boards continues to be identified as insufficiently mixed [43]. In determining the right combination of expertise, skills and backgrounds it is also necessary to consider the stage and activities of the business and changing requirements over the lifespan of a company.

In PwC's 2014 survey of boards, the top three reasons directors identified for diminished performance were aging, a lack of the required expertise, and poor preparation for meetings. Over half of directors who have served on a board for less than one year believe a fellow board member should be replaced – but fewer than 25 per cent who have served more than 10 years feel the same. The biggest hurdles to replacing an underperforming colleague lie with the board leadership's discomfort in addressing the issue, followed by a lack of individual director assessments [43]. Many boards fail to formally assess their performance and even those that do can feel more like they are ticking boxes than genuinely looking at opportunities for improvement.

Good governance is agreed as pretty straightforward if basic principles are understood and actually followed. In reality it is hard to do when existing logic and practices are working against what good looks like. The first step for reform is in recognition of a problem to be solved.

> "Given the long record of women achieving the highest qualifications and leadership positions in many walks of life, the poor representation of women on boards, relative to their male counterparts, has raised questions about whether board recruitment is in practice based on skills, experience and performance."

– Women on Boards. Lord Davies of Abersoch reporting to the UK Government.



> "The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy. It will also reshape capitalism and its relationship to society. Perhaps most important of all, learning how to create shared value is our best chance to legitimize business again."

– Michael Porter and Mark Kramer

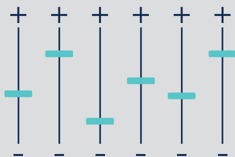
A QUICK GUIDE TO
GREAT GOVERNANCE
INSTRUCTION HANDBOOK

> “Systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day, it is the acts or omissions of people charged with relevant responsibilities that will determine whatever governance objectives are in fact achieved.”

Australian National Audit Office. Public Sector Governance Volume 1.

1 Create clarity about principles, the model, roles and focus:

High performance starts with clear, well-documented and well-understood principles, as well as clarity around roles, scope of responsibilities, expected behaviours and contribution. Describe and educate members on the model being worked to.

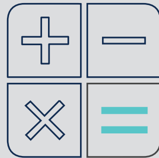


2 Develop a balanced membership:

Composition is vital. Seek demographics, skill sets and experience to bring the variety of perspectives that will enhance critical thinking and decision-making: independence, background, industry experience, life experience, age, gender, culture and attitude. Get the right number. Too few (< 4) and too many (> 8) are equally problematic. Provide and encourage ongoing professional development, as those who stop learning and challenging their thinking will quickly become redundant.

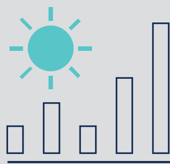
3 Create the environment for an effective Chair:

Your Chair sets tone, direction and culture. They need to have a performance orientation and the skills to create an environment of genuine engagement; knowing how to draw out opinions and shape discussions. Expect them to deliver. Assess delivery. But be mindful that the whole board has a role to play in creating an environment for their success, through application of their skills, their preparedness and by providing regular, honest feedback about what might be improved. Simple metrics can assess ongoing effectiveness for the team if there is an environment of trust in which they can be completely candid. Succession, for the Chair, directors and the CEO, is also a key mechanism of sustainability and should be reviewed on an annual basis. We all have a use-by date.



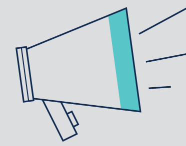
4 Deliver a balance of stewardship and strategy:

On one side of the equation, compliance, robust risk management and social and environmental impact management are critical. Ensure legal and ethical understanding and frameworks are clear and accompanied by the strong financial management that underpins ongoing viability. Strategy for future performance is the other side of business sustainability. It requires a constant heads-up attitude, working with unknowns, gathering internal and external data to ensure due diligence in decision-making that will have a direct impact on how the business will perform in the years ahead. Allocate the proper time, resources and capabilities needed for each of these different roles.



5 Create a climate of trust and honesty:

Establish values really clearly. For example: honest, act with integrity, act in the company's best interests at all times, make sure you have the right mix of skills and experience, ask the hard questions, make only well-informed decisions. Arrange for directors to get to know the business, to meet with teams and to visit the workplace/s. Set up regular reports and dashboards of important information and provide these to members in time to read and digest before any meeting. An effective board also needs an open and honest relationship with its CEO.

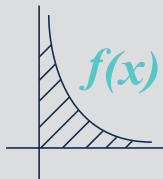


6 Foster a culture of open and well-managed dissent:

Encourage exploration of different ideas. Ask quieter members for their opinions and views. The goal is to disagree but not be disagreeable, because through dissent and discussion a better outcome will be achieved. Develop alternative scenarios to evaluate strategic decisions. Challenge norms. Create an expectation of excellence as standard. The board should never be subordinate to the CEO nor a majority shareholder. An environment like this would be a reason to reassess participation.

7 Evaluate performance:

Independently assess board performance on an annual basis against agreed criteria. Share the results. Set up ongoing feedback loops for directors' views on–and confidence in–the integrity of the enterprise, the quality of processes and discussions at the meetings, the credibility of reports, the use of constructive professional dissent, the level of interpersonal cohesion, the degree of knowledge about the business and external conditions. Examine initiative, roles, participation and energy levels. Set goals and measure progress.



8 Manage sustainable value and stakeholder engagement as a business function:

Like any business function, sustainable value and stakeholder engagement should be driven by well-defined strategy and have clear objectives, timetables, budgets and allocation of responsibilities. All staff should be aware of these programmes and understand why they are being undertaken and the implications they might have.

9 Ensure accountability:

Be clear about where the buck stops. Make the responsibility of the role of Director clear-cut and detail the expected contribution of time, skills and attention – then hold members to that commitment. Give members tasks that require them to inform the rest of the group about strategic and operational issues the organisation faces, to keep them up to date. Always expect 100 per cent accountability.

Good governance requires getting to know the real logic (internal and external) behind the day-to-day operations of the business, which requires robust, timely information, clarity about goals and objectives and regular, honest assessment of progress. Once established, well-enacted governance can be an effective mechanism for ensuring sustainable quality of direction and continuous improvement.

Why you would:

Evidence suggests that where companies invest more in governance policies and practices, it creates better operational and market results – share price, liquidity, cost of capital and profitability can be key outcomes [44]. Improved results hold in both growth markets and in times of economic downturn.

Several other key benefits have been identified:

- Improved top level decision-making processes
- Better control environments
- Reduction in firms' cost of capital
- For companies listed on a stock exchange, there is a positive effect on share value, liquidity and investor portfolio composition.

It is not only external metrics that can reflect benefits. The critical internal benefit is that effective governance enables owners (and executives) to roll out a transparent strategic direction across the business. This allows all those involved to understand the role they play in the ongoing success of the organisation, which in turn improves business development. This means that the employees, executive team, directors and external stakeholders can all be aligned and motivated in a cohesive way.

> "Integrity is doing the right thing even when nobody's watching you."
>
> – C.S. Lewis

Manila Water Company: Reaping the benefits of stakeholder engagement

From its inception in 1997, Manila Water Company in the Philippines has sought to have a proactive and open relationship with its stakeholders, including customers, local NGOs and government. Good stakeholder relationships are viewed as fundamental to the core business of the company, which is to provide clean, safe water and sewerage services to approximately half of Manila's population.

When Manila Water acquired the East concession from the government operator, it launched a "Walk the Line" program in which all company staff – from managers to district level representatives – visit their customers, including residents of informal settlements, to consult with them on the delivery of these essential services to their community.

As a result of this engagement and other initiatives, Manila Water has significantly improved its service delivery. Between 2004 and 2006, the percentage of households with a 24-hour water supply jumped from 26 per cent to 95 per cent. At the same time, water loss from the system was reduced from 63 per cent to 35.5 per cent. From 325,000 households served at the start of 2004, there were more than 1,000,000 in 2006, including 848,000 urban poor.

The company's proactive stakeholder engagement strategy has also led to a number of partnerships that have benefited local communities, including housing reconstruction through Habitat for Humanity and micro-financing to start small businesses through the Bank of the Philippine Islands. Manila Water has established Engagement Plans for key NGO stakeholders, the media and Investors, which include quarterly dialogues and visits to the company's sustainable development and community projects.

Reported in the IFC's guide to stakeholder engagement in governance [37]

Last words

The big questions our experts think boards should be asking themselves as they head into 2020.

Performance:

Do you have the right measures in place to understand how you are doing as a board and as a business? Do you have the right skills and mix around the table? Are you sufficiently informed to make the right decisions around both risk and investment?

Sustainability:

What is being done to ensure the long-term viability of the organisation from an economic, financial, social and environmental perspective? What is in place to understand, assess, resource, implement and monitor strategies to address each of these elements of sustainability?

Strategy:

Is strategy appropriately resourced? How often and when is this key function undertaken? Has strategy been set to deliver long-term results? Does the CEO and management team have clear understanding of the board's expectations in relation to goals, objectives and performance?

Risk:

Does the board understand and clearly articulate its appetite for risk? Have individual board members participated in the development of the risk management plan? Is risk an agenda item at every board meeting? How is risk management balanced against the ongoing need for innovation and business development? Is cyber security and digital risk on the agenda?

Resources:

Does the organisation have the right people in the right jobs at the right time to deliver strategy? Is the infrastructure appropriate to support the staff and the business? Are a master plan and capital expenditure plan in place? Are plans measured and reviewed at board level on an ongoing basis?

Compliance:

Does the board have a compliance register to which it can refer, update and review to provide some degree of comfort that the organisation's compliance obligations are being met on an ongoing basis? Does the board engage external resources, if internal capability is not sufficient, to deliver the required outcomes in this area? Is compliance understood as an investment in success and embedded in the culture?

Succession planning:

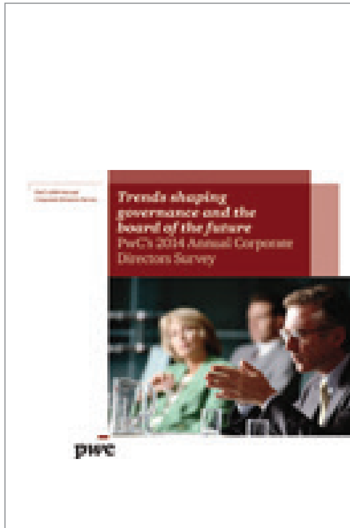
Is there a plan in place for the orderly succession of the CEO, the chairman and individual board members? Are there any contingency plans in place for potential succession emergencies? Does the CEO have a succession plan in place for key management within the business? Is succession an agenda item on at least one board meeting each year?

Effectiveness:

Does the board have and allocate appropriate time and resources to deliver on its responsibilities? Is the right governance structure in place to support the organisation? Is an annual review undertaken and professional development program developed to assist performance? Does the board have the right skills and attitude to lead the organisation in its quest for success?

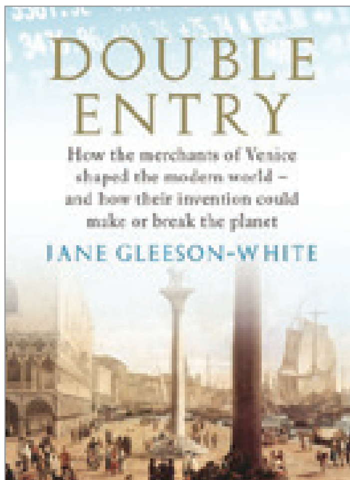
WORDS OF
WISDOM

Some reading

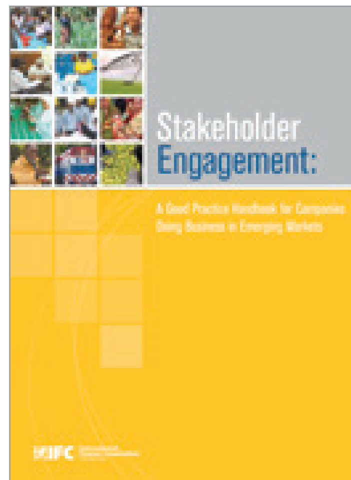


49.

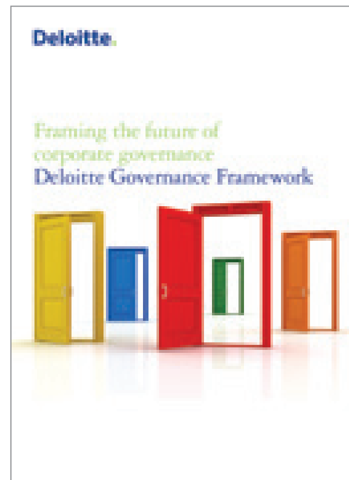
50.



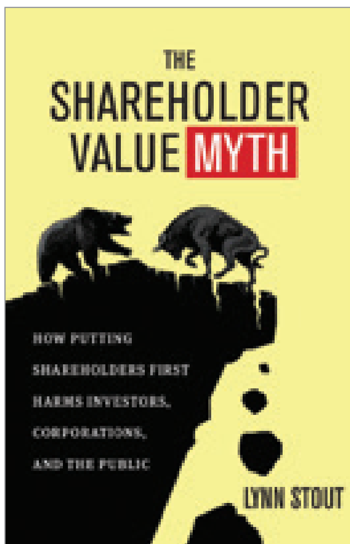
51.



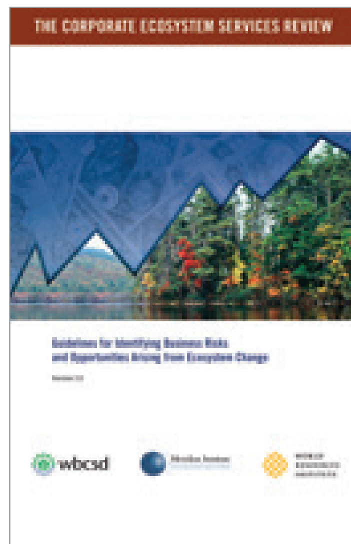
52.



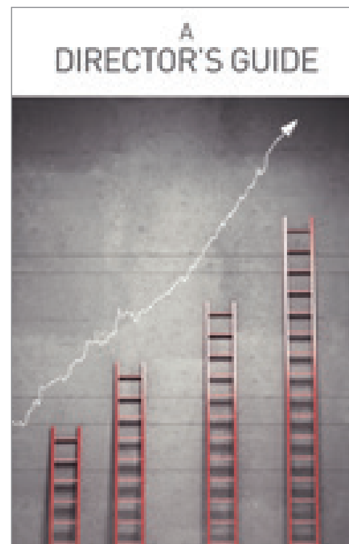
53.



54.



55.



56.

References

1. Cheffins, B. R. (2012).The History of Corporate Governance. European Corporate Governance Institute: University of Cambridge.
2. Wells, H. (2010). The Birth of Corporate Governance. Legal Studies Research Paper Series. 4(33), p1247.
3. Berman, H.J. (1983). Law and Revolution: The Formation of the Western Legal Tradition. Vol. 1. Cambridge: Harvard University Press.
4. Morck, R. K. and Steier, L. (2005). A History of Corporate Governance around the World: Family Business Groups to Professional Managers. The National Bureau of Economic Research.
5. Khanna, V.S. (2005) The Economic History of the Corporate Form in Ancient India. Social Science Research Network.
6. Achbar, M., Abbott, J. and Bakan, J. (2007) The Corporation. Big Picture Media Corporation. www.thecorporation.com
7. Gomory, R. and Sylla, R. (2013) The Corporation. Daedalus [forthcoming]: American Academy of Arts and Science Association.
8. Stout, L. (2012). The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations and the Public. San Francisco: Berrett-Koehler Publishers, Inc.
9. Pearlstein, S. (2014). When Shareholder Capitalism Came to Town. The American Prospect www.propspect.org
10. Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. New York Times Magazine.
11. Business Roundtable. (1977). Statement on Corporate Governance. p1-2.
12. Martin, R. (January, 2010). The Age of Customer Capitalism. Harvard Business Review.
13. Gleeson-White, J. (2013). Double Entry. How the Merchants of Venice Shaped the Modern World – and How Their Invention Could Make or Break the Planet. Allen & Unwin.
14. Panfilii, A. and Popa, L. (2012). Failure of Corporate Governance: Intention or Negligence. www.actionamresponsabil.ro
15. Jordan, C. (2012). Cadbury Twenty Years On. Melbourne Law School: Center for Transnational Legal Studies Research Papers.
16. The Committee on the Financial Aspects of Corporate Governance and Gee and Co. Ltd. (1992). Report of the Committee on the Financial Aspects of Corporate Governance. European Corporate Governance Institute.
17. Dempsey, A. (2013) Evolutions in Corporate Governance: Towards an Ethical Framework for Business Conduct. Sheffield: Greenleaf Publishing.
18. Maira, A. (2010). The Conscience of Capitalism. Forbes India
19. Deloitte. (2012). Framing the future of corporate governance: Deloitte governance framework. Deloitte LLP Center for Corporate Governance.
20. Grcic, J. (2011). The Conscience of the Corporation. Annales Philosophici. 2, 41-50.
21. Rugg-Gunn, M. (2012). The Psychology of Effective Board Decision Making. Norman Broadbent Leadership Consulting www.normanbroadbent.com/AppContent/The%20Psychology%20of%20Effective%20Board%20Decision-Making.pdf
22. ISS (2011) 25 for 25: Observations on the Past, Present, and Future of Corporate Governance. MSCI: www.issgovernance.com

References

23. Higgs, D. (2003). The Higgs Report: Review of the Role and Effectiveness of Non-Executive Directors. London: The Department of Trade and Industry UK.
24. Lewis, M. (September, 2014). The Secret Goldman Sachs Tapes. Bloomberg View. www.bloombergview.com
25. This American Life. (2014) 536: The Secret Recordings of Carmen Segarra. In This American Life Radio Archive. www.thisamericanlife.org/radio-archives/episode/536/the-secret-recordings-of-carmen-segarra.
26. Porter, M. and Kramer, M. (January/February 2011). Creating Shared Value. Harvard Business Review.
27. Freeman, R. E. (2009). What is Stakeholder Theory. Business Roundtable Institute for Corporate Ethics, Editor. www.corporate-ethics.org.
28. World Wildlife Fund (2008) Living Planet Report 2008. WWF: http://d2ouvy59p0dg6k.cloudfront.net/downloads/living_planet_report_2008.pdf
29. Patel, R. (2010). The Value of Nothing: How to Reshape Market Society and Redefine Democracy. New York: Picador
30. Srinivasan, U. T. et al. (2008) The debt of nations and the distribution of ecological impacts from human activities. Proceedings of the National Academy of Sciences of the United States of America. 105(5), 1768-1773.
31. The Integrated Reporting Initiative, T.I.R. (2014) The International Integrated Reporting Council.; Available from: www.theiirc.org
32. Global Reporting Initiative. (2014). www.globalreporting.org
33. Gilligan, G. (2011) Jérôme Kerviel the 'Rogue Trader' of Société Générale: Bad Luck, Bad Apple, Bad Tree or Bad Orchard? The Company Lawyer 32(12), 355-362.
34. PwC. (2013). PwC Annual Corporate Directors Survey 2013. US: PwC
35. Farrell, S. (June 24, 2014) FTSE 100 companies face scrutiny on succession planning. The Guardian. www.theguardian.com/business/2014/jun/24/napf-succession-planning-leadership-ftse-100
36. Maher, M. and Andersson, T. (1999). Corporate Governance: Effects on Firm Performance and Economic Growth. Organisation for Economic Co-operation and Development [OECD].
37. International Finance Corporation. (2007). Stakeholder Engagement: A Good Practice Guide for Companies Doing Business in Emerging Markets, Washington: IFC World Bank Group.
38. Hart, S, (2011). Strategies for Sustainable Value. www.stuartlhart.com/sustainablevalue.html
39. Plumptre, T. and Graham, J. (1999). Governance and Good Governance: International and Aboriginal Perspectives. Institute on Governance: Publications.
40. Team FME. (2013). Porter's Five Forces: Strategy Skills. Free Management Books: www.free-management-ebooks.com/dldebk-pdf/fme-five-forces-framework.pdf
41. Coady, M. and Kahn, N. (2011). Business at its Best: Driving Sustainable Value Creation. Accenture & CECP: www.accenture.com/us-en/Pages/insight-business-best-sustainable-value-summary.aspx

42. 4Imprint (2010) Corporate Governance for Small Business. 4Imprint Blue Papers. info.4imprint.com/wp-content/uploads/1P-17-1210-December-Blue-Paper-Goverance.pdf

43. PwC. (2014). Trends Shaping Governance and the Board of the Future: PwC's 2014 Annual Corporate Directors Survey. http://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/assets/annual-corporate-directors-survey-full-report-pwc.pdf.

44. Latin American Companies Circle and IFC (2009). A Practical Guide to Corporate Governance: Experiences from the Latin American Companies Circle. Available from www.ifc.org

45. Chapman Tripp. (2014). The Australasian governance challenge - our old Hilux vs their new Volvo. www.chapmantripp.com/publications

46. PwC. (2014). 17th Annual Global CEO Survey: Key findings for New Zealand, PWC, Editor. http://www.pwc.co.nz/ceosurvey

47. Senate SHJ and NZ Institute of Directors. (2013). Managing Reputation in New Zealand: An Investigation into Perceptions of Reputation and Risk Management. http://senateshj.co.nz/sites/default/files/Managing%20Reputation%20in%20New%20Zealand%202013.pdf

48. Slade, M. (2014). Study Shows SME Governance Gap. stuff.co.nz (Unlimited) www.stuff.co.nz/business/unlimited/63001538/Study-shows-SME-governance-gap

49. PwC. (2014). Governance Trends Shaping the Board of the Future: PwC's 2014 Annual Corporate Directors Survey. www.pwc.com

50. Theory of Successful Māori Businesses. www.manu-ao.ac.nz

51. Gleeson-White, J. (2013). Double Entry. How the Merchants of Venice Shaped the Modern World – and How Their Invention Could Make or Break the Planet. Allen & Unwin.

52. International Finance Corporation. (2007). Stakeholder Engagement: A Good Practice Guide for Companies Doing Business in Emerging Markets. www.ifc.org

53. Deloitte. Framing the Future of Corporate Governance: Deloitte Governance Framework. www.deloitte.com

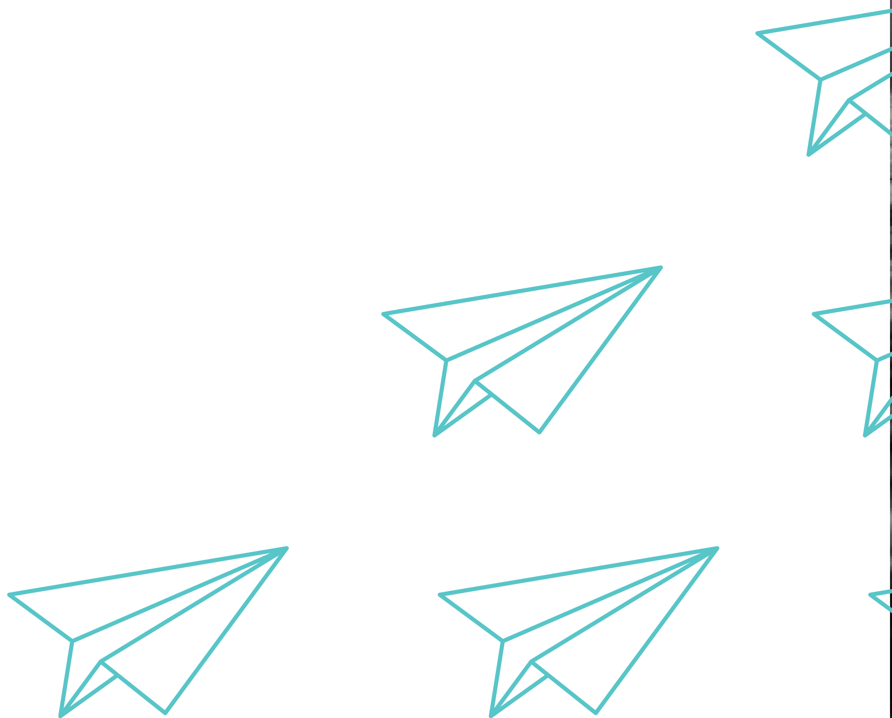
54. Stout, L. (2012). The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations and the Public. San Francisco: Berrett-Koehler Publishers, Inc.

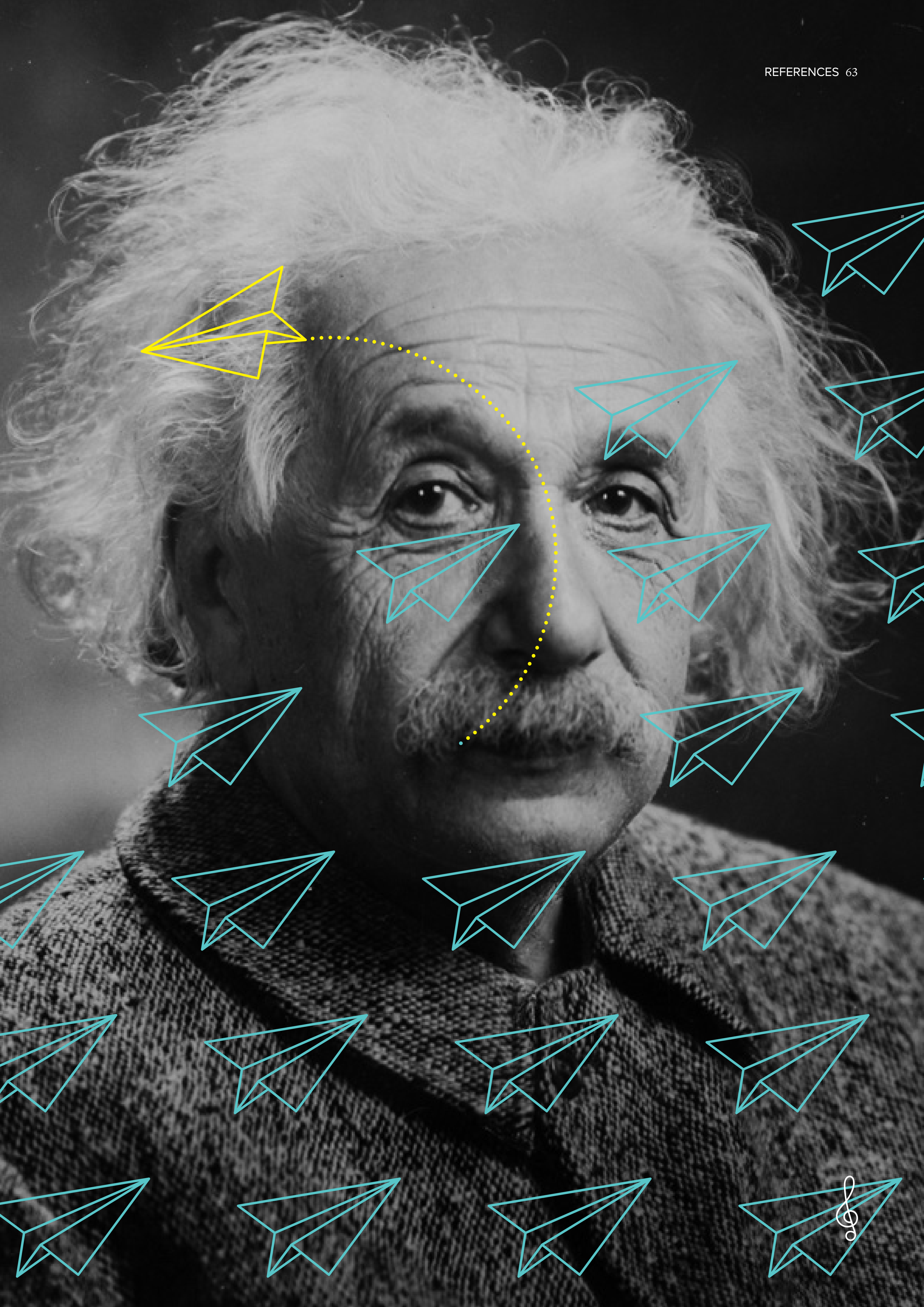
55. The Corporate Ecosystem Services Review. Guidelines for Identifying Business Risks and Opportunities Arising from Ecosystem Change: World Resources Institute. www.wri.org

56. Institute of Directors in New Zealand/Financial Markets Authority. (2013). A Director's Guide. www.fma.govt.nz

"The problems we have today, cannot be solved by thinking the way we thought when we created them."

– Albert Einstein





STRING THEORY

You are free to copy, distribute or use String Theory publications in any way.

You are also free to credit the authors, treat your fellow humans with respect, tread lightly on the planet and reap the karma benefits with which all these courses of action will inevitably shower you.