CONTROL VS COORDINATION – A WAY TO CORPORATE GOVERNANCE PERFORMANCE

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Abstract: *This paper is the result of the analysis of the key characteristics of 'good corporate governance', its 'best practices' and case studies of corporate scandals in attempt to identify why controls are not enough. The theoreticians and practicioners put great effort in to overcome weaknesses in corporate governance, though these efforts are not a guarantee of a corporations' survival or success. New variations of old remedies (more rigid controls and supervision) were not just unsuccessful but turned out to be counterproductive. The solution which is just emerging requires a completely new approach – a new paradigm. A new paradigm does not rely on corporate 'governance' focused on more control and supervision but rather on 'leadership' based on 'spiritually intelligent' responsibility. In this context it is not about 'control' but a 'coordination' that reconcile various interests, expectations and goals in order to empower the whole system (the corporation together with all the stakeholders) to achieve its goals and realize its raison d'être. This apporach puts a human being and his/her deepest motivational factors, i.e. human nature in the first place since he/she is a creator and carrier of all the processes and systems.*

Key words: *corporate governance, control, organizational culture, coordination, human nature.*

1. INTRODUCTION

The goal of this paper is to determin a reason why control as a dominant tool of corporate governance does not bring the desired results and to find out which prerequisties should be in place in order to provide good performance of corporate governance. The main assumption of this paper is that current and previous theory and practice of corporate governance does not pay enough attention to the needs and goals of other stakeholders such as customers, managers, employees, society, the public etc. The fact is that problems are generally solved by focusing on their consequences, instead of looking into causes which lead to those undesired results.

The evolution of corporate governance practices over time implied more controls and more rigid monitoring of executive management, but it did not provide a guarantee that performance would be created ([1], [4]). Although there is some evidence that good corporate governance results in direct economic benefits for an organization ([2] and [3]), case studies of great corporate collapses ([4], [5]) shows that formal satisfaction of all requirements of good corporate governance is not a guarantee of success.

Many authors (such as[19], [20], [21], [22], [23]) agree that the use of control theory in the field of organizational behavior is inadequate. Also, motivational incentives as a tool of governance can be rather counterproductive ([29], [30], [31], [32],) [33], [34]).

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By analysing the lessons learned from the past we suggest a new way to performance - a concept of ’coordinate governance’ which would be based on comprehension of and respect for human nature and its driving forces (as suggested by [37], [38], [39], [40], [41]). This new synergy/power would enable to face both the micro and macro challanges more effectively. Finally, reality confirms and scientists agree that such an approach brings results ([42], [43], [44], [45], [46], [47], [48], [49], [50], [51]).

Therefore, the aim of this paper would be to move the focus away from *controls and supervision* which are generally seen as foundations of good corporate governance, onto a *coordination* based on comprehension of basic factors affecting this process such as human nature and its driving forces (motivational factors). Being aware of, understanding and respecting human nature as well as coordinating human energy and potential (through ’coordinate governance’) would lead to higher efficiency and effectivness in doing business.

2. METHODS AND MATERIALS

In the process of testing the established hypotheses the author of this paper has applied standard scientific methods such as: description, analysis and synthesis, inductive and deductive methods, abstraction and concretization and the method of comparation.

During the research conducted for the purpose of this paper, the author has analysed relevant literature from the field of corporate governance, expert articles, official documents, reports and regulations, relevant scientific research and studies, as well as other sources which are directly or indirectly related to the subject of the paper. Based on comparative analysis of all collected sources, the author managed to reach common indicators and general conclusions regarding the defined hypotheses and goals.

3. RESULTS AND DISCUSSION

3.1 Characteristics of Good Corporate Governance

Depending on the type of the organization the expectations of its stakeholders regarding corporate governance vary. However, they all have something in common, as they are all expected to meet the same characteristics of *good* coroprate governance. Literature from this field usually considers seven basic characteristics of corporate governance (see [1]), such as: *discipline*, *independence*, *accountability*, *responsibility*, *fairness* and *social responsibility*.

According to [2] a study, conducted by Georgia State University, published in December 2004, revealed that public companies with independent boards of directors enjoyed higher returns on equity, higher profit margines, higher dividend returns and higher stock repurchase. Similar results were reached by another study, conducted by MIT Sloan Shool of Managemnt of over 250 companies (see [3]). This study concluded that when companies had advanced information technology, on average, *governance practices* (good governance) generates 25% higher profits than is the case with companies with weak governance with the same strategic goals.

If considering only the formal aspect of good corporate governance, its characteristics sound like something which would guarantee business success. However, according to [1] there are some aspects that may stand in the way of corporate governance. The fact is that even good corporate governance is subject to consideration of cost-benefit analysis.

3.2 A Few Facts of Corporate Scandals in USA

In order to identify laches of good corporate governance it is necessary to understand the triggers for modern corporate scandals, especially those escalating at the beginning of 21st century as they created modern corporate governance as we know it today.

As [4] noted, despite the recommendations of the Blue Ribbon Committee and the Securities and Exchange Commission's (SEC) strong assurances that such recommendations would enhance the reliability and credibility of financial statements, corporate scandals and flagrant abuses continued at an accelerating rate. If we look at the conclusions and comments of the analysts of these scandals it is easy to see that they all agree it was all about *human greed, ego, and arrogance* (e.g. see: [5], [6]). As [4] noticed, companies such as Enron, WorldCom, Adelphia, Tyco and Global Crossing were *in full compliance, formally at least, with all applicable requirements for board and audit committee independence*. However, it would be hard to find any corporation in the 1970s whose management behaved with comparable piracy.

Throughout the last 30-40 years monitoring mechanisms (controls) were more and more rigid and obligatory, but yet, they did not prove to be effective. The reason is in their formality (e.g. regarding directors' independence...), and finding a unique remedy that would fit all sizes (*set of standards*) without deeper analysis of actual causes of problems. For example, according [7], in the case of Enron, it was not a strategy which Enron used that led it to the end, but the way Enron used that strategy. The causes of all corporate scandals can be found in: *human greed, ego, arrogance, irresponsibility, negligence, ignorance but also in an enormous creativity which can be used in both ways – ethically and unethically*.

3.3 The Role of Code of Conduct

It is generally known that the modern literature on corporate governance places more and more emphasis on company behaviour and ethics. In some cases, a code of conduct is not just recommended but it is required to be adopted, implemented and disclosed in public (e.g. Report of the National Commission on Fraudulent Financial Reporting, 1987; COSO Report, 1992; 'Sarbanes-Oxley Act of 2002').

Codes of conduct are concerned with several aspects of 'desired' behaviour including moral aspects of human behaviour inside the organization. Ethics is just another aspect of corporate governance which gets more attention. In last couple of years, many organizations have paid attention to corporations' ethics and social responsibility. Since all 'hard' aspects of corporate governance, i.e. controls are/will be regulated by the law, these 'soft' aspects will make the difference. As [8] concluded, 'soft', subjective factors in corporate governance attract less attention from scientists and journalists but they are of key importance in the real world of corporate behaviour. These soft factors include social issues and issues of morality and health and safety.

3.4 Reasons Behind Controls Ineffectiveness

Through close examination and estimation of 'corporate governance best practices' (see [9], [10]) it is impossible to disregard the fact that vast number of recommendations, including the introduction of a number of policies, procedures, rules, codes, i.e. controls and monitoring in the broader sense, actually conceal the essence of good corporate governance (*responsibility,*

independence, ethics and integrity, fairness and objectivity, all-inclusiveness, disclosure, efficient communication, knowledge and information, remuneration, other forms of capital).

Aligning individual behaviour with organizational goals is a critical concern of management, i.e. corporate governance. However, [11] idendify several studies providing empirical evidence that individual behaviour can often deviate from organizational goals which can lead to suboptimal performance, inefficiency and organizational dysfunction (e.g. [12], [13], [14]).

Management uses planty of tools to make people do what they have to do in order to reach the goals of the organization, but all of them can be classified in two basic groups: controls and motivational incentives. Control theorists (e.g., [15], [16], [17], [18]) applied the basic model of a mechanical control system to humans. However, the use of control theory in the field of organizational behavior has been repeatedly criticized by many authors such as [19], [20], [21], [22], [23]. The assumption underlying control theory as well as other goals approaches (see [24]) is that all purposeful behavior follows a 'goal→behavior' sequence. However, [25] pointed out that organized collective action, as well as individual behavior in organizations, often *precedes* goal definition. Thus, specific formal and informal aspects of the organization such as evaluation and reward systems, decision rules, the dominant logic or rationality (see [26]), organizational interpretation modes (see [27]), norms, values, and culture and the social context, among others, can have profound effects on goal-setting, changing and retrospective goal inferences. In other words, goal-setting and change is not just an individual process in which people develop goals and sub goals in a hierarchical order according to means-ends relationships. It is also, as [28] point out, a social process in which individuals develop goals in order to make their (in)actions rationally accountable to themselves and to others.

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Corporate governance uses incentives as means of aligning goals and motivating an individual's best possible performance. However, research presented by [29], [30] and [31] indicates that incentives can also reinforce or even establish a misalignment of goals. Corporate scandals such as at Enron, as well as the recent economic crisis, suggest that the misalignment of goals as a consequence of incentives can even lead to the collapse of established firms. When considering

financial incentive, the reliance on such incentives is based on the underlying assumption of expectancy theory [see 32] and more specifically that individual behavior is mostly motivated by expected money rewards. However, [33] identified several studies (e.g. [31], [34]) concluding that financial incentives can lead to myopic behavior and ultimately precipitate organizational failure.

This leads us to the concept of organizational culture, which is defined by [35] (see also [36]), as *a system of shared values (that define what is important) and norms that define appropriate attitudes and behaviors for organizational members (how to feel and behave).* From small groups to entire societies, organizations are composed of individuals. [37] argue that if we are to have a science of such organizations, it will have to be founded on building blocks that capture as simply as possible the most important traits of humans. According to these authors, understanding human behaviour is fundamental to understanding how organizations function. Humans are creative beings who respond creatively both to the opportunities the environment presents and constraints that prevent them from doing what they wish. They care about money, but also about other things such as respect, honour, power, love and the welfare of others. Therefore the real question is how to coordinate human energy in ways that increase rather than reduce the effective use of such creative and uncontrollable resource (see [38]).

According to [39], meaning, creativity and purpose are the three deepest motivational factors of every human being. They are not psychological processes, but spiritual contents constituting the foundation of spiritual intelligence. Thus, the basic challenge of governance is to enable all actors to participate in a creative process, make them feel significant and understand clearly the value of their contribution. Professor Drucker [40] in his book Management in Next Society suggests that all groups should work closely, in one company, in order to produce the desired result.

Therefore, a basic reason why controls are not effective results form the fact that corporate governance best practices are missing leadership based on spiritual intelligence (see [41]). All key terms, included in corporate governance best practices, actually point out the importance of bringing all interests, goals and needs on the same coordinate. This could be the basis of a new paradigm and a new approach to governance, named 'coordinate governance'. *Coordinate governance* would be the governance focused on *common vision, integrity, mutual trust and respect, true values, state of spirit and energy in the organization, organizational culture, recognition and satisfaction of needs and expectations of all stakeholders.* While corporate governance is mainly based on supervision and control, *coordinate governance* should be based on comprehension of human nature and all inner potentials constituting human being – intelectual, emotional, creative, spiritual.

3.5 Real Life and Science Confirms

Coordination based on managing human behaviour can have a powerful influence on the attitudes and behaviours of individuals within organizations. But the real question is whether it also has an impact on an organization's effectiveness? [42] revealed that in a study of the best companies to work for in Canada that they were also the most successful companies in terms of shareholder return and sales growth. Fast Company magazine reported how the Gallup Organization undertook an exercise to process 30 years' worth of data on worker attitudes to try and answer one simple but crucial question: ''What does a strong and vibrant workplace look like?'' (see [43]). According this research, the most ''engaged'' workplaces were 50% more likely to have lower turnover, 56% more likely to have higher-than average customer

loyalty, 38% more likely to have above-average productivity and 27% more likely to report higher profitability.

[44] argues that organizations can no longer achieve a competitive advantage through the traditional sources of success, such as technology, regulated markets, access to financial resources and economies of scale. Today, the main factor that differentiates organizations is the workforce and the most successful organizations are those that effectively manage their employees. [45] showed in his research work that there is a strong correlation between management style and staff satisfaction, and that both of them are positively affected by organizational culture. Also, [46] identified even 55 scientific papers that study the relationship between organizational culture and performance and indicate their direct interrelation.

According to [47], one of the priorities of strategic leaders in 21. century will be establishment and maintenance of healthy organizational culture that focuses on key values such as innovation, learning and valuation of human capital and team work. Unlike the previous ones, modern researchers believe that organizational culture can be used in achieving competitive advantage, effective work and staff productivity (see [48]). Many other researches as well, such as [49], [50], [51] confirm that the strong organizational culture is the prerequisite in creating better organizational performance and sustainable competitive advantage.

4. CONCLUSION

Over the recent years we have been witnesses to escallating and unexpected ’business disasters’. Such disasters were not confined to the USA, but have encompassed the whole corporate world. A number of measures have been taken in order to overcome these crises. However, common opinion is that, even where there are laws and regulations, auditors, securities commissions etc., stakeholders and public are still the vicitms of frauds and corporate scandals. For this reason, corporate governance is under more and more preassure. One of the issues it is faced with relates to the number of codes implying voluntary implementation of recommendations on good corporate govrnance. One of the anaswers to the collapse of large corporations was to make recommendations and rules more obligatory. Nevertheless, even if corporations stick to such rules 100%, they can still ’deceive’ their stockholders and stakeholders. Enron serves as an example for this but, unfortinately, it is not the only one. For this reason, instead of supporting rigid, defined frameworks, business should rely more on ’ethics and values’, ’fair-play’, integrity, sincerity etc., since companies simply cannot let themselves make the same mistakes again - just one more is enough to lead to an unhappy ending.

If modern corporations wish to survive and fulfill their ’raison d'être’ they have to start behaving responsible and in a ’spiritually intelligent’ way. Corporate governace should transcend into ’coordinate governance’ which task would be to enable all stakeholders to approach the same coordinate in order to produce the desired result. Therefore, financial results (profits) cannot be the only goal. It should be placed in the same coordinate with the goals of all stakeholders involved in the business process. This requires: ethics existing on a higher level, comprehension and respect of human nature and thinking ’out of the box’. Solving problems in a business world will not be possible without an integral overview of what lies ’beneath the surface’. The top of iceberg is only 1/10 of its total size. This means that theoreticians and the academic world should begin with a behavioral approach which perceives problems in the broader context and encompasses all scientific and practical areas, including comprehension of human nature and coordiantion of human creative energy.

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