Towards responsible corporate governance

Lutgart Van den Berghe, Vlerick Leuven Gent Management School, and Céline Louche, Vlerick Impulse Centre for Business in Society

Corporate governance is one of today's most prominent business challenges. Recent scandals and increasing public scrutiny show that financial corporate governance needs to be complemented and challenged by societal governance.

Redefining the basic paradigms

Historically, mainstream corporate governance has been dominated by the traditional neoclassical view of the firm, focusing on shareholders and financial performance. The emphasis has been on financial corporate governance and especially on conformity. This led to a tick-box approach with a few superficial adaptations. This has been detrimental when dealing with the reality of governance challenges. It is therefore of crucial importance to enlarge the corporate governance model in order to recognise that firms are complex and intertwined in a web of stakeholder relations.

A number of paradigms need to be revised.

First, we need to redefine the role of the firm from a 'business within society' perspective, hence integrating modern theories of the firm and alternative theories, such as the resource-based view, the knowledge-based view, the networker view and the communitarian view (Van den Berghe and Carchon 2003).

Second, one of the big challenges for corporate governance is to shift from the traditional principal–agent theory to the management of complex principal–agent relationships, thus taking stakeholders' interests into consideration. We need to integrate complex sets of relationships and their potential conflicts of interest into our governance structure and develop mechanisms to manage them effectively and efficiently.

Third, corporations need to think beyond shareholder interests towards sustainable value creation (George 2001; Atkinson *et al.* 1997).

Finally, the question is whether there is convergence on the dominant firm logic. The concept of 'dominant firm logic' is based on those governance structures that are used as the reference for developing (national) laws, regulations and self-regulatory recommendations. Today, the dominant firm logic is based on the Anglo-American model (Berle and Means 1932) of the publicly listed company with dispersed shareholding. However, the prevailing global firm logic is relevant only for certain types of firm (Van den Berghe *et al.* 2002). Optimal corporate governance can be developed along two lines: while basic corporate governance principles are universal, their translation and implementation in practice need to take into account the different types of firm (and its relevant governance challenges and problems).

The societal responsibilities of firms need to be fully integrated into corporate governance and management, both in practice and in theory. There is a clear need for another kind of corporate monitoring, one that also covers negative externalities.

The board of directors and senior management have a crucial role to play. But the role of shareholders in the monitoring system should not be underestimated. They have shown a strong awareness of social concerns. This is especially apparent in the case of the socially responsible investment movement (Louche and Tagger 2005). Institutional investor activism could well become the most important force in rethinking corporate governance paradigms.

Future challenges

Managing conflicts of interest: ensuring that the interests of the company come first

Conflicts of interest have been at the heart of numerous corporate scandals where private interests prevailed over the long-term interests of the company. But the impact of business failures goes far beyond the loss of shareholder value and is especially damaging to societal values. The challenge now is to eliminate conflicts of interest by strengthening the role of (independent) internal and external monitors.

Redefining the role of the board: making the right trade-offs

The board of directors is the first instrument for monitoring the firm. It therefore needs to be aware of its enlarged duties. Sound governance ensures that all relevant responsibilities will be addressed via a well-constituted board of directors, and that a balance will be struck in dialogue with the management. Several contributions have been proposed on the enlarged role of the board (Pfeffer and Salancik 1978; Hung 1998). One of the key elements is to integrate the stakeholder approach. Some countries have been leading the way: for example, the UK with the Turnbull report or France with CSR reporting by the board of directors.

More effective monitoring by independent and objective directors

The presence of a sufficient number of independent directors on the board and in its subcommittees can help create the right boardroom culture, but is no guarantee that directors will then have the right attitude. It is important to distinguish between 'formal independence' (absence of possible conflicts of interest) and 'independence of mind' (attitude of independent thinking). To ensure effective control, we need the latter. We should note the effort of the High Level Group of Company Law Experts (2002) and the Sarbanes–Oxley Act to strengthen and increase 'formal independence'.

Empowering the board to look beyond short-term shareholder value

Empowerment is crucial in order for the board to perform its role as internal monitor. New governance recommendations and codes attach great importance to this issue. Here, we believe that shareholders have an important role in creating the responsible firm, particularly in refocusing the attention of the board towards long-term value creation. As of today, active monitoring by institutional investors is still underdeveloped. It could be stimulated if we could make them accountable for the role of business in society.

No effective monitoring without information

The adequacy and reliability of the information process is critical, particularly in view of the asymmetry of information that exists between insiders/executives and outsiders/non-executives, sometimes even between the representatives of the reference shareholder and the other directors. One cannot expect a director to perform an effective monitoring role without correct and timely information. Every board of directors and every board member should strive for the right information and evaluate its quality periodically.

Responsible governance is not only the duty of businesses

Responsible governance is also the duty of other organisations, including institutional investors, state-owned enterprises, supra-national, non-governmental and governmental organisations, whose impact is expanding quickly. These organisations are not immune to conflicts of interest and control bias problems. Therefore they will need to carefully monitor their own corporate governance.

References

Atkinson, A.A., J.H. Waterhouse and R.B. Wells (1997) 'A Stakeholder Approach to Strategic Performance Measurement', *Sloan Management Review* 38: 25-37.

Berle, A., and G. Means (1932) *The Modern Corporation and Private Property* (New York: Macmillan).

George, W.W. (2001) 'Medronic's Chairman William George on how Mission-Driven Companies Create Long-Term Shareholder Value', *Academy of Management Executive* 15.4: 39-47.

Hung, H. (1998) 'A Typology of the Theories of the Roles of Governing Bodies', *Corporate Governance: An International Review* 6.2: 101-11.

Louche, C., and J. Tagger (2005) 'Socially Responsible Investment: Now and Looking Forward', *Public Service Review* 9: 20-22.

Pfeffer, J., and G.R. Salancik (1978) *The External Control of Organizations: A Resource Dependence Perspective* (New York: Harper & Row).

Van den Berghe, L.A.A., A. Levrau and C. Van der Elst (2002) *Corporate Governance in a Globalising World: Convergence or Divergence? A European Perspective* (Dordrecht, Netherlands: Kluwer Academic Publishers): 223.

—— and S. Carchon (2003) 'Redefining the Role and Content of Corporate Governance from the Perspective of Business in Society and Corporate Social Responsibility', in P. Cornelius and B. Kogut (eds.), *Corporate Governance and Capital Flows in a Global Economy* (Oxford: Oxford University Press): ch. 23.

Lutgart Van den Berghe is an executive director and partner of Vlerick Leuven Gent Management School, Belgium, and head of the school's Competence Centre Entrepreneurship, Governance and Strategy. She is a part-time professor at Gent University (corporate governance) and serves as a non-executive director in a number of listed and non-listed multinational companies. Her research interests focus on corporate governance, institutional investors and financial conglomerates. She is academic director of the Belgian Directors' Institute.

Céline Louche is a senior researcher at the Vlerick Impulse Centre for Business in Society, Belgium.