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Guidance on corporate governance

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Corporate governance is a system where decision making meets accountability. There is a general belief good corporate governance contributes to improved company performance by retaining shareholders, improving efficiencies, increasing information and minimizing overall risks. The last 15 years has seen a rise in SEC and stock exchange requirements around corporate governance. Institutional groups and proxy advisory firms have also jumped into the fray publishing their own "best practices." Best practices are seen as the right approach because no one framework will work for every company.

Board directors play a critical role in serving as guardians of our corporate governance systems. This is not an easy task particularly when corporate governance is a combination of objectives, processes and relationships. Further complicating the role is the dynamic between a board's oversight function and their need to manage when management is failing. In the wake of increasing financial volatility, internal company scandals and difficulties associated with meeting performance goals, shareholders are questioning the effectiveness of our corporate governance systems and losing faith in the ability of our boards to execute on their fiduciary duties.

Dysfunctional System of Corporate Governance

The difficulty lies in the fundamental premise that the value in corporate governance is the product it produces, i.e., a policy statement or set of guidelines. In fact, many companies have conformed to "standard" governance best practices. However, this "check-the-box" approach is fundamentally flawed. The key to successful application of good corporate governance is implementation. It is not the list of outcomes or practices but how a company goes about achieving those that matters.

In many cases, organizations end up consisting of two environments. One environment encompasses the rules, the other the actions. Although a set of guidelines for good corporate governance may exist, organizational players often socialize and negotiate their own set of rules and actions to heed. This generates a dichotomy between what is written and what is acted upon ultimately leading to a dysfunctional system.

Implementation of Good Corporate Governance Systems

To improve corporate governance, a company has to undergo systemic change. Because corporate governance permeates all parts of a company, this type of change requires uncovering deficiencies between individuals in the company and deficiencies between the company and broader environment. The board is intended to serve as the guardian of this function. It is not the role of a board to execute implementation but rather to set the stage and then question each and every step along the way. From an organizational implementation perspective, there are strategies that can assist with improving corporate governance and board directors should be focused on guiding their companies in these areas.

Vision is crucial. Corporate governance is intended to demonstrate the values of transparency, accountability and trust to stakeholders. The current "best practices" focus on the specific rules that should govern in an effort to demonstrate these values. A larger vision is necessary and vision must be specific to the company and the industry in which it operates. While it is most successful for vision to come from the top, the ultimate success of that vision will depend on the extent to which it is informed by all stakeholders. Board directors can help management define this vision by encouraging generation of input from within and outside the company.

Clear stakeholder roles are imperative. Most of the corporate governance literature focuses on the role of the board and management. While this is critical, the focus should encompass a broader set of stakeholder roles including shareholders, support functions, customers and suppliers. Understanding and identifying how these players contribute to the operation of corporate governance is a critical first step in ensuring better implementation. A board should understand the relevant stakeholders and assist management with developing a taxonomy through which to establish and understand these roles as well as ensure constant consideration of these roles throughout implementation.

Strategies must be top-down and bottom-up. Corporate governance permeates an entire corporate system. For the system to be effective, the strategies for implementation must be both top-down and bottom-up. Management needs to develop their own strategies but they also must gather input from the support functions in the company and partner to develop a set of strategies that will lead to successful execution of corporate governance. The board can guide management by maintaining a lens of critical analysis to ensure both inclusion of and continuity

in top-down and bottom-up implementation.

Conflict is inevitable. Whenever multiple viewpoints are considered, conflict is inevitable. Most companies and boards strive to avoid conflict or conflict becomes a façade of dysfunction resulting in inefficient processes which hamper corporate governance. Conflict must be recognized and encouraged. The board of directors should welcome conflict and be adept at assisting management through using conflict towards productive outcomes.

Incentives must align with outcomes. This is where implementation often fails. The ways in which companies structure financial and other incentives does not provide a strong basis for ensuring accomplishment of outcomes. The reasons for this are twofold. First, there is no clear path between objectives and outcomes. Second, because there is no clear path, the ability to evaluate success is difficult and, as a result, the incentives do not reward the right behaviors and outcomes. When this happens, the ability to create a system of good corporate governance becomes difficult. Board directors must serve as stewards in ensuring this alignment. It is a critical function of their outside and independent oversight.

Evaluation is fundamental. Tied to the above strategy, evaluation of success is a critical function. While companies understand how to assess financial performance, they are woefully behind when it comes to assessing other types of performance. While this failure ultimately has a negative impact on the company's financial performance, the link is not always clear and even less understood. As a result, companies tend to adopt very cursory forms of evaluation that are not tied to specified outcomes and this creates a broken feedback loop. The board of directors should be focused on ensuring assessment is rigorous and focused.

Conclusion

While all of these strategies apply for all companies, each company will be unique in terms of where they are deficient and how best to implement depending on their particular context. The board of directors can help companies to identify those deficiencies and strive for implementation improvement in an effort to improve corporate governance systems. By doing so, companies will be far more effective at demonstrating the values of transparency, accountability and trust to stakeholders. This will also help restore public perception of our boards of directors as true guardians of our governance functions.

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