

As a result of the many corporate scandals that have taken place around the world, best-practice corporate governance guidelines have been developed in most countries. Internationally, the biggest influence on these guidelines has come from the Institute of Directors (IoD)<sup>1</sup> in London, through the advice they provide to other nations. Many countries that do not actually contract with the IoD for advice, nonetheless incorporate aspects of the IoD thinking in their best-practice guidelines.

This is a positive development, although the following issues should be noted:

1. The Anglo-American model of governance is being promoted as the global standard
2. Soft law does not necessarily address the soft dimensions of a firm (in other words, laying down a new soft law does not replace the need for integrity in board relationships and processes) and
3. Best-practice guidelines are typically designed for large, publicly listed firms

In adopting corporate governance guidelines developed elsewhere, companies should be aware of the fact that best-practice guidelines<sup>2</sup> for:

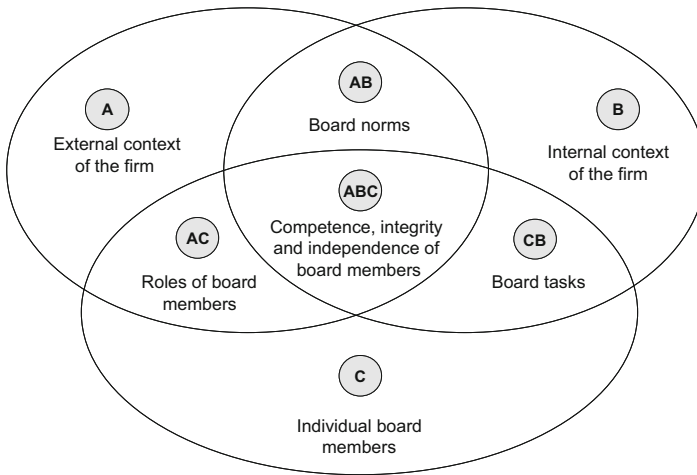
|                  |   |                        |
|------------------|---|------------------------|
| Listed companies | ≠ | Non-listed companies   |
| Large companies  | ≠ | Small companies        |
| Public companies | ≠ | Family-owned companies |
| Bank governance  | ≠ | Hospital governance    |
| US companies     | ≠ | British companies      |

Hence we base our approach on the principle “Keep it situational.”

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<sup>1</sup> See [www.iod.com](http://www.iod.com).

<sup>2</sup> Encouraged by the Swiss Federal Counsellor Doris Leuthard, the former Swiss “Minister of Economics”, the IFPM Center for Corporate Governance has developed “Governance Recommendations for SME” with practice proven board-practice-tools and checklists. See: [www.ccg.ifpm.unisg.ch](http://www.ccg.ifpm.unisg.ch) (click on “Best Practice”). Switzerland was the first country to publish “Best Practice in SMEs”.



**Fig. 2.1** Determinants of a firm's success. (See McGrath 1976, p. 1320 ff)

Besides the board members themselves, the fit between the external and internal contexts is the most important determinant of a firm's success (see Fig. 2.1).

In this chapter we review the external and internal context factors that have a lasting impact on firm success.

## 2.1 External Business Context

In the external business context I differentiate between institutional culture, national culture, and the normative context.

### 2.1.1 Institutional Context

To explain the institutional context, we use “actor-centered institutionalism.” (see Scharpf 1997). This new approach “bridges the gap between under-socialized agency theory approaches and over-socialized views of institutional theory” (Aguilera and Jackson 2003, p. 448). Thus it is possible to explain the differences between corporate governance rules, systems and practices in different countries on the basis of various institutional mechanisms. Those mechanisms define the impact on, and the roles of the different stakeholder groups.

The agency theory paradigm that has been dominant in research and practice<sup>3</sup> ignores the perspective of corporate governance as “ultimately the outcome of interaction among multiple stakeholders.” (Aguilera and Jackson 2003, p. 449).

<sup>3</sup> Since the seminal work of Berle and Means in 1932.

According to Aguilera and Jackson (Aguilera and Jackson 2003, p. 450), a comparison of corporate governance systems suggests that three stakeholder groups need to be taken into account:

- (A) providers of capital
- (B) employees and
- (C) management

- (A) At the level of the providers of capital, the key question is: should the investment in a firm be primarily financially motivated or primarily strategically motivated? Where should the emphasis lie – should investors have a speculative or a long-term value approach? What should be the ratio of owners' equity to debt in a firm? If the equity proportion is high, as is usually the case in the United States, then the shareholders' interests are more central. If the debt proportion is high, as is usually the case in Japan, then the interests of other stakeholder groups are more central.

The different national contexts are differentiated from one another along the following institutional fault lines:

- Property or ownership rights
- Financial infrastructure or the type of financial system and
- The nature and extent of inter-firm networks

In addition, the context of listed firms is influenced by the extent of shareholder activism (see, for example, Marens 2002, p. 365).

Thus the following relationships can be represented (see Fig. 2.2).

- (B) The interests of the employees are neglected in corporate governance literature, with the exception of literature emanating from Germany.

Institutional contexts are differentiated from one another along the following lines:

1. Representation of employees on the board and
2. The power of trade unions

The equal voting rights granted to employee representatives on the supervisory boards of big German firms and the significance of company unions in Japanese firms are examples.

- (C) The interests of top management as a stakeholder group have not yet been adequately studied in the corporate governance literature. There are grounds to believe that many of the recent corporate governance scandals can be related to the one-sided, help-yourself orientation of top managers, a phenomenon I refer to as a *top-executive value* orientation.

Institutional contexts are strongly differentiated from one another based on dominant management ideologies and dominant thinking about career paths. Whereas countries with presidential political systems (top-down approaches, such as those evident in France or the United States) generally grant CEOs considerable power and support, firms in countries with non-presidential political systems tend to be led in a more consensus oriented style. And corporate

| Institutional conditions                                      | Motivation of participants |           | Investment time horizon |           | Proportion of own capital |     |
|---------------------------------------------------------------|----------------------------|-----------|-------------------------|-----------|---------------------------|-----|
|                                                               | Strategic                  | Financial | Short-term              | Long-term | High                      | Low |
| <b>(1) Ownership rights</b>                                   |                            |           |                         |           |                           |     |
| a) Countries which privilege majority shareholders            | ×                          |           |                         | ×         |                           |     |
| b) Countries which protect minority shareholders              |                            | ×         | ×                       |           |                           |     |
| <b>(2) Financial system</b>                                   |                            |           |                         |           |                           |     |
| a) Countries with primarily bank-based financial systems      |                            |           |                         | ×         |                           | ×   |
| b) Countries with primarily market-oriented financial systems |                            |           | ×                       |           | ×                         |     |
| <b>(3) Nature and extent of inter-firm networks</b>           |                            |           |                         |           |                           |     |
| a) Countries with complex inter-firm networks                 | ×                          |           |                         | ×         |                           |     |
| b) Countries with few or simple inter-firm networks           |                            | ×         | ×                       |           |                           |     |

**Fig. 2.2** Financial and economic relationships. (Aguilera and Jackson 2003, p. 453 f)

governance practices are strongly influenced by whether careers are advanced primarily within a firm, as in Japan, or by changing firms, as is the case in the United States.

Then the question arises, “how [does] the combination of institutional domains in a particular country shape corporate governance at the firm level?” (Aguilera and Jackson 2003, p. 454).

Three types of conflict could surface:

1. *Class conflicts* could arise when the interests of top management and shareholders are too much at odds with the interests of employees (for instance, in salary negotiations)
2. *Conflicts between insiders and outsiders* can arise when the interests of top management and employees (insiders) oppose the interests of the shareholders (outsiders)
3. *And alignment conflicts* can arise when the interests of shareholders and top management are too divergent (e.g. the firing of a CEO)

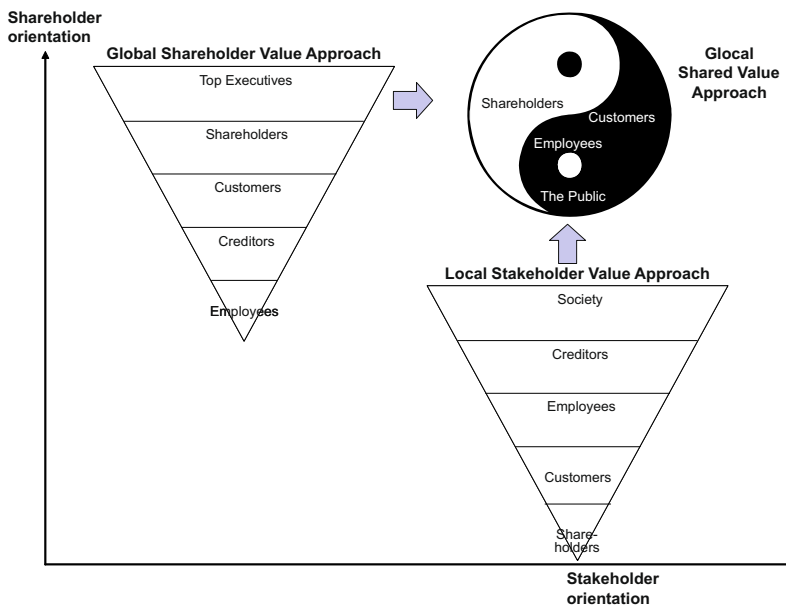
## 2.1.2 National Context

A review of international corporate governance literature allows us to differentiate between the value orientations of three types of boards (see Fig. 2.3).

Those with:

- A primary orientation towards top executive and shareholder utility maximization (often evident in large, listed American firms)<sup>4</sup>
- A primary orientation towards maximizing value for providers of debt and employees (often evident in large Japanese firms) and
- A simultaneous orientation towards shareholders, customers, employees and the public (often evident in world-class transnational – or what we call *glocal* – firms)

Usually, large US firms have relatively high equity stakes, whereas large Japanese firms usually have relatively low equity stakes. If 80 % of the capital is provided by shareholders, then the shareholder approach and a short-term, “quarterly results” orientation can take precedence. Conversely, if only 20 % of the capital comes from shareholders, then those shareholders are less important, and the



**Fig. 2.3** Value orientation of boards

<sup>4</sup> See for example, the shareholder orientation in Shleifer and Vishny (1997, p. 737), the stakeholder orientation in Donaldson and Preston (1995, p. 65), which is criticized by Stoney (2001), and the *glocal* approach proposed by Hilb (2003).

long-term orientation of large Japanese firms is better understood (see Gedajlovic and Shapiro 2002).

The ranking of the significance of the different stakeholder groups in many US firms differs considerably from the ranking of the different stakeholder groups in large Japanese firms. In the United States, one can talk about a *top executive value* mindset; shareholders also have a central role. Employees, with the exception of top management, have a less significant role. Society and the environment are often irrelevant.

A Gallup survey conducted in the United States reported that “90 % of Americans felt that people running corporations could not be trusted to look after the interests of their employees, and only 18 % thought that corporations looked after their shareholders a great deal. Forty-three percent, in fact, believed that senior executives were only in for themselves.” (Handy 2002, p. 54; cf. Euractiv 2010).

Conversely, in large Japanese companies, society, external capital providers and employees (including top executives) have a central role, whereas until the recent economic crisis in Japan, shareholders had an insignificant role.

We have shown in a comparative study that, for a world-class company to be consistently more innovative and successful than its competition globally, the board has to systematically and sustainably pursue and regularly measure the satisfaction and the voluntary loyalty of shareholders, customers, employees (including management), and the public. Such *glocal* firms<sup>5</sup> exist in many countries (the biggest, according to the *Financial Times*, is Nestlé).<sup>6</sup> Similarly, there are many *glocal*, family-owned businesses, for example: Thompson in Canada, L'Oréal in France, Schindler in Switzerland, Hilti in Liechtenstein, Toyota in Japan, and Tata in India.

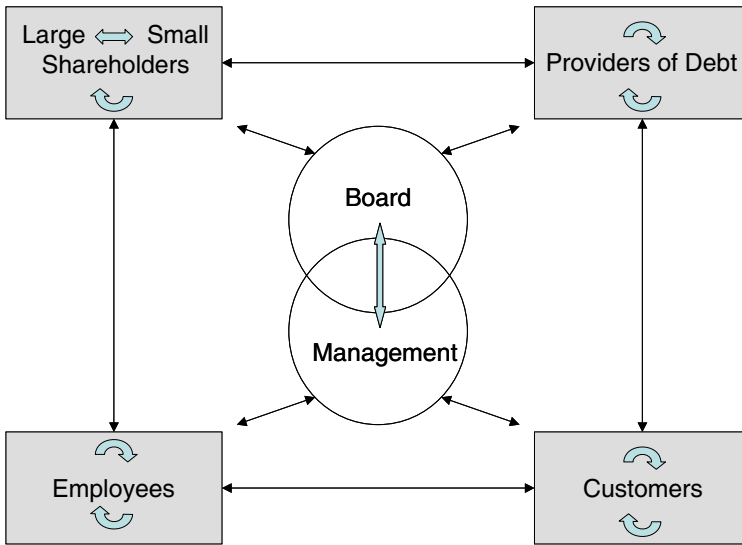
Such *glocal* firms are “among the most important (if not the most important) contributors to wealth and employment . . .” (Neubauer and Lank 1998, p. 11) in many countries. A *Forbes* study confirms that these firms were “on average 15 % more profitable and 14 % faster growing than the industry average and one third more profitable when controlling for size variations.”<sup>7</sup>

In order to achieve such a *glocal* orientation, the following critical question has to be asked within a firm: “Whom and what is a business for? The answer once seemed clear, but no longer. Ownership has been replaced by investment, and a company's assets are increasingly found in its people . . . Both sides of the Atlantic would agree that there is, first, a clear and important need to meet the expectations

<sup>5</sup> Firms we call *glocal* demonstrate both a shareholder- and a stakeholder orientation to corporate governance, giving “local partners, institutions and community groups adequate information on the activities of MNCs operating in their context, and the institutional means to have a voice in their decisions” (Child 2002, p. 147).

<sup>6</sup> According to Stern-Stewart, Nestlé ranks seventh in the world on the Wealth Added Index (WAI). It is the biggest food company in the world and, according to the *Financial Times*, the biggest transnational company in the world (i.e. one of the few companies governed by a truly multicultural board).

<sup>7</sup> *Forbes* (22 May 1995) in Neubauer and Lank (1998, p. 11).



**Fig. 2.4** Stakeholder conflict: inter- and intra-group

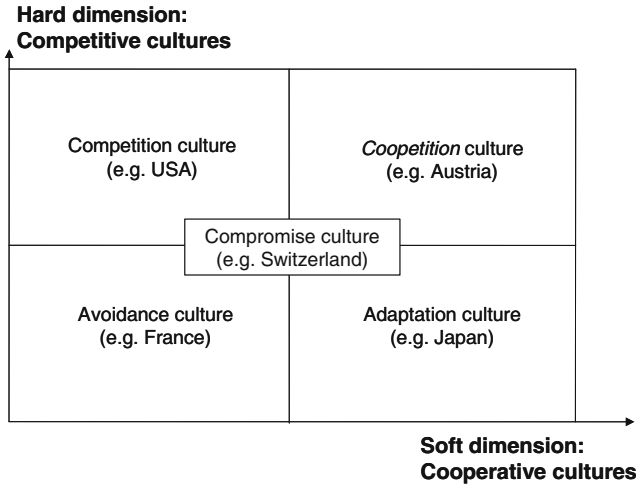
of the company’s theoretical owners: the shareholders. It would, however, be more accurate to call most of them investors, perhaps even gamblers ... But to turn shareholders’ needs into a purpose is to be guilty of a logical confusion. We need to eat to live; food is a necessary condition of life. But if we lived mainly to eat, making food a sufficient or sole purpose of life, we would become too large. The purpose of a business ... is to make profit so that the business can do something more or better.”<sup>8</sup>

The South African “King III” best-practice guidelines are among the few guidelines in the world to explicitly endorse an orientation that concerns itself with the interests of stakeholders beyond the shareholders (Kapp, in Noetzli 2004, p. 44). Such an orientation, however, requires that firms have the capacity to identify and manage the conflict that often arises within and between different stakeholder groups (see Mann 2003, p. 53; Fig. 2.4).

Corporate governance practice is strongly influenced by national culture. Countries can be divided into five groups according to the level of their orientation towards competition and cooperation (see Fig. 2.5).

Hard and soft national cultures can be differentiated from one another along the following dimensions, in Fig. 2.6.

<sup>8</sup> Handy (2002, p. 51). Carter and Lorsch (2004, p. 56) support this idea: “If we look into the future, the idea that boards are responsible solely to shareholders becomes increasingly suspect.”.



**Fig. 2.5** National culture differences (based on the MODE model)

Every positive attribute can also be a liability when it is over emphasized. Laurent (1997) identified the following limitations of both cultural dimensions, i.e. those which have an enduring impact on corporate governance practices in any country.

The attributes of national cultures also determine the normative regulations in a given country (Fig. 2.7).

|    | Dimension            | Type of Culture           |                                     |
|----|----------------------|---------------------------|-------------------------------------|
|    |                      | Hard                      | Soft                                |
| 1  | Time horizon         | Short-term                | Long-term                           |
| 2  | Emphasis             | Task orientation          | Relationship orientation            |
| 3  | Driving force        | Goals                     | People                              |
| 4  | Reinforced qualities | Performance and mobility  | Commitment and loyalty              |
| 5  | Motto                | “Nobody is indispensable” | “Foster cooperation and networking” |
| 6  | Decision making      | Fast (top-down)           | Slow (bottom-up)                    |
| 7  | Goal                 | Transparency              | Innovation                          |
| 8  | Strategy             | Clarity                   | Flexibility                         |
| 9  | Distinctive feature  | Predictability            | Adaptability                        |
| 10 | Feedback             | Controllability           | Reaction speed                      |

**Fig. 2.6** Hard and soft national cultures. (Laurent 1997)

|    | Hard Culture                     | Soft Culture                        |
|----|----------------------------------|-------------------------------------|
| 1  | Over-structuring                 | Confusion                           |
| 2  | Excessive short-term orientation | Insufficient short-term orientation |
| 3  | Demotivation of the individual   | Constraints on the individual       |
| 4  | Obsession with numbers           | Obsession with the group            |
| 5  | Lack of social grace             | Resistance to change                |
| 6  | Obsession with planning          | Obsession with vision               |
| 7  | Micro management                 | Ambiguity                           |
| 8  | Exaggerated belief in the system | Exaggerated power games             |
| 9  | Rigidity                         | Chaos                               |
| 10 | Overemphasis on the market       | Overemphasis on hierarchy           |

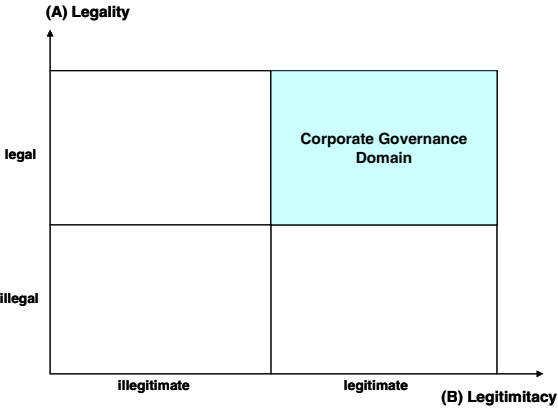
**Fig. 2.7** Comparison of the shadow sides of hard and soft national cultures

2.1.3 Normative Context

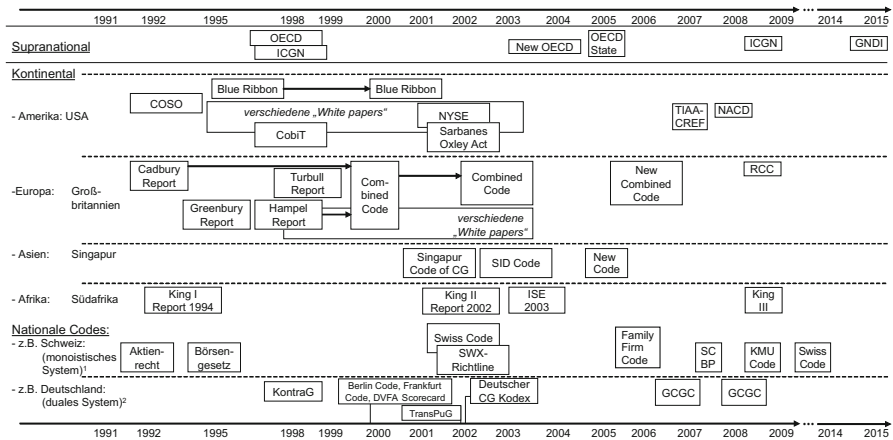
In the normative context, there are two dimensions – legality and legitimacy – as shown in Fig. 2.8.

Normative rules of corporate governance should encourage the behavior of all members of the supervisory and managing boards to behave both legal and legitimate.<sup>9</sup>

**Fig. 2.8** Corporate governance domain



<sup>9</sup> Indeed, institutional theory describes how firms develop within the constraints imposed by society and law (see Meyer and Rowan 1978, for discussions of institutional theory).



**Fig. 2.9** A time line of the development of selected international and national codes and laws on corporate governance. (See Graf, Waldersee and Laufermann in Pfitzer and Oser (2003, p. 460 ff) for a comment on the European Commission’s action plan for improvement of corporate governance by 2008; c.f. [www.ecgi.org/codes](http://www.ecgi.org/codes))

## Legality of Board Management

In the domain of corporate governance, a distinction is made between hard and soft norms. What is legally prescribed and socially recommended differs greatly from country to country. The following graphic depicts an overview of the development of international codes and laws on corporate governance (see Fig. 2.9).

1. **In Switzerland** (see recommendations from Erny 2000; Ackermann in Noetzli 2004, p. 15, and Volkart and Cocca in Noetzli 2004, p. 12) the “Economie Suisse” recommendations (see Hofstetter 2002, 2014) are geared towards large, publicly listed companies. They do not apply equally to medium-sized publicly listed companies, and are not at all suited to unlisted SMEs (see Behr in Noetzli 2004, p. 23, also Hopfmüller 2010).

Due to an initiative of the Swiss Federal Counsellor Doris Leuthard, the Center for Corporate Governance developed governance recommendations for SMEs. You will find them at [www.icfcg.org](http://www.icfcg.org) (click Board Guidelines).

2. **In Germany** (see Pfitzer and Oser 2003), known for its relatively high level of regulation and relatively low number of listed firms (see Mann 2003, p. 132 f), the co-determination practice that includes representatives of employees on the supervisory board (see Pfitzer and Oser 2003) (the most extensive involvement of employees in corporate governance worldwide), leads to a board that is too big and complex to act effectively and to hold critical discussions on central and delicate subjects (see Hax in Noetzli 2004, p. 53). It is therefore important to look for alternative approaches.

In Switzerland, since the shareholder reform of 1991, boards enjoy relatively wide ranging powers. According to paragraph OR 716a of Swiss commercial law,

the board actually has powers for both direction and control, with the following inalienable rights and tasks:

1. “the strategic leadership of the organization
2. the direction of the organization
3. the determination of the accounting, financial control and financial planning systems
4. the appointment and termination of the CEO
5. the monitoring of implementation of strategy by management
6. the production of the annual report, the preparation of the AGM and the overseeing of the implementation of its decisions [and]
7. informing the courts in the case of financial crisis.”

In many countries, the mission of the board is limited to a supervisory function.

Important legal developments in corporate governance internationally are, for example:

- In the United States, the “Sarbanes-Oxley Act”(2002)
- In Canada, the “S-11 Bill” (2001)
- In the UK, the “Combined Code” (2003) and (2006)
- In Japan, the “New Commercial Code” (2003) and
- In France, “*La Loi de Sécurité Financière*” (2003)

As a result of the numerous corporate crises, many countries have developed corporate governance guidelines (as soft law). After the financial crisis of 1997, the OECD principles of corporate governance were published as a global point of reference for international policy dialogue in 1999 and further refined in 2004 and 2014. The Global Network of Director Institutes has published Global Corporate Governance Guidelines in 2015 ([www.gndi.org](http://www.gndi.org)).

There is considerable variance between the levels of development of corporate governance (best-practice) recommendations. Surprisingly, the highest standard of corporate governance best-practice recommendations worldwide is reflected in the South African “King III” report (see King 2002, 2009 and Kapp in Noetzli 2004, p. 44), which incorporates, *inter alia*, recommendations regarding risk management and “Integrated Sustainability Reporting”.

On each continent, the following countries play a leading role as far as corporate governance recommendations are concerned: in Europe, the UK (*New Combined Report* 2009), in Asia, Singapore (2005), in the Americas, Canada (2002) and in Africa, South Africa (2009).

Two facts are remarkable:

1. With the exception of the UK, the most important industrial countries, such as the United States, Germany, Japan and France, are not the most exemplary from the points of view of either best practice guidelines or effectiveness of corporate governance practice. The best examples are to be found in the smaller countries: for guidelines, South Africa, Singapore and Canada, and for practice, Finland, and New Zealand.

2. Even well-polished codes and recommendations are not enough if integrity does not receive sufficient attention in addition to hard and soft law. Daniel Johnston, General Secretary of the OECD, noted that “do we want a world based on values? Rules will always have loopholes, and there will always be those who spend their time trying to wriggle through them. This thinking appears to have invaded much of the corporate world. Are our students today learning values or learning rules? I hope both, but with a good dose of the former. Because any set of rules alone, if disconnected from the values that those rules are ultimately meant to reflect, is like a body without a soul”.<sup>10</sup>

This leads us to the second central dimension of the normative context.

### **Legitimacy of Board Management**

All corporate governance reforms at the level of hard and soft law and firm’s value statements are useless if the board members lack integrity. The following example of an international company’s mission statement graphically illustrates this point (Fig. 2.10).

#### **Communication**

We have an obligation to communicate. Here we take the time to talk with one another. And to listen. We believe that information is meant to move and that information moves people.

#### **Respect**

We treat others as we would like to be treated ourselves. We do not tolerate abusive and disrespectful treatment.

#### **Integrity**

We work with customers... openly, honestly and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we won’t do it.

#### **Excellence**

We are satisfied with nothing less than the very best in everything we do. We will continue to raise the bar for everyone. The great fun here will be for all of us to discover just how good we can really be.

**Fig. 2.10** Example of the mission statement of an international firm

<sup>10</sup> See Johnston (2003, p. 3). Also, Carter and Lorsch (2004, p. 15) record the following statement by a board member: “Our board satisfies all the requirements of Cadbury, Greenbury and Hampel, but our board meetings are a complete waste of time.” cf. Bradford et al. (2010, p. 6 ff).

| <b>Firm-ethics ranking</b> | <b>Europe</b> | <b>North America</b> | <b>Asia</b> | <b>Africa</b> |
|----------------------------|---------------|----------------------|-------------|---------------|
| 1                          | Denmark       |                      |             |               |
| 2                          | Finland       |                      |             |               |
| 3                          |               |                      | Australia   |               |
| 4                          | Norway        |                      |             |               |
| 5                          |               |                      | New Zealand |               |
| 6                          | Sweden        |                      |             |               |
| 7                          |               | Canada               |             |               |
| 8                          |               |                      | Singapore   |               |
| 9                          | Switzerland   |                      |             |               |
| 10                         | Luxembourg    |                      |             |               |
| 11                         | Netherlands   |                      |             |               |
| 12                         |               |                      | Japan       |               |
| 13                         | Germany       |                      |             |               |
| 14                         | Austria       |                      |             |               |
| 15                         |               | USA                  |             |               |

**Fig. 2.11** Ranking of executive boards corporate ethics behavior. (Garelli 2010, p. 396)

This mission statement sounds truly enticing. But words are cheap. This mission statement belonged to ENRON. One year before its collapse, ENRON was elected one of the best US firms as far as corporate governance was concerned. It failed because of a lack of integrity in areas critical to good governance. And it demonstrates how quickly companies found lacking in such areas can move from “first to worst”!

Integrity, a cornerstone of economic activity, is not present in the same measure in all countries (see Fig. 2.11).

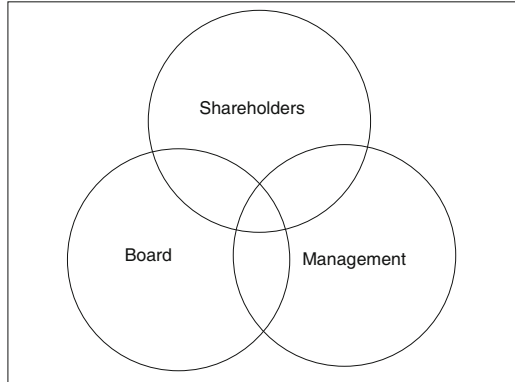
It appears that in this ranking is missing most Asian, Latin American, Eastern European, Middle Eastern and African countries.

Transnational firms would benefit from the development of *glocal* rules of integrity. The thoughts on world-ethics from Kueng (Kueng 2001) and the “King III” report (King 2009, p. 108 ff), which are in “Chapter 3: Ethical Practices and Organizational Integrity” for corporate governance practice, constitute a starting point.

Boards have the central task of ensuring the continued existence of a firm in the interests of all relevant stakeholders, with integrity. The board members act as representatives of different and partially overlapping interest groups. In publicly traded corporations, the main stakeholder groups are as follows (see Fig. 2.12).

In family-controlled businesses, family members are also important stakeholders (see Fig. 2.13).

**Fig. 2.12** The board in a publicly traded firm. (Neubauer and Lank 1998, p. 14)

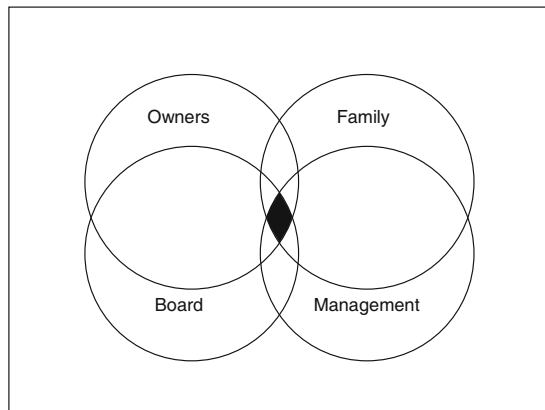


In this case, emerging conflicts of interest must be recognized and avoided by careful attention to board composition.<sup>11</sup>

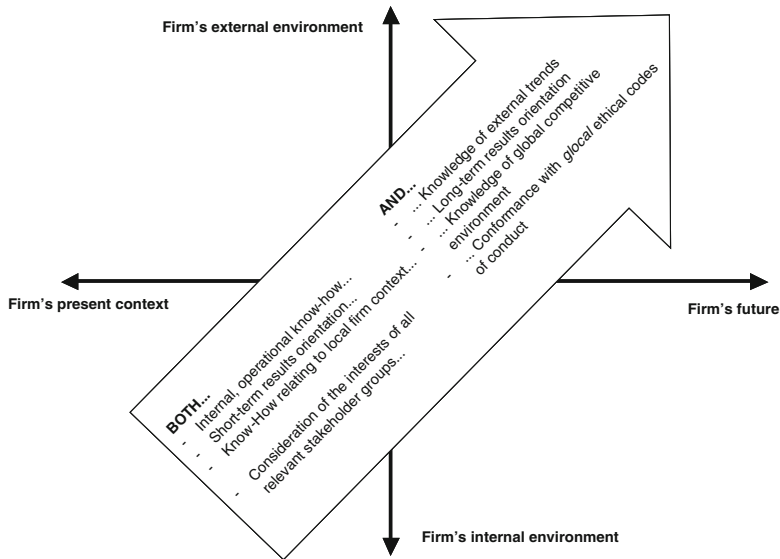
I have adapted an important maxim from an old Jamaican proverb:

“Never take a board seat you can’t afford to lose.”

**Fig. 2.13** The board in a family-controlled business



<sup>11</sup> According to the new regulations of the New York Stock Exchange (1 Aug. 2002), listed firms are required to create a “Code of business conduct and ethics”, including clauses addressing, for example, “**Conflicts of interest:** should be prohibited and a method should be provided for communicating potential conflicts so they can be avoided . . . **Encouraging the reporting of any legal or unethical behavior:** the company should proactively promote ethical behavior and ensure there will be no retaliation” Vermeulen (2002, p. 22).



**Fig. 2.14** “Both-and” goals of boards

To ensure that firms survive and thrive, boards need “both-and” goals (as illustrated in Fig. 2.14).

This brings us to the internal board context.

## 2.2 Internal Business Context

The following internal context dimensions influence corporate governance:

- Ownership
- Board configuration
- Organizational complexity
- Board role players
- Degree of internationalization
- Mix of board functions

### 2.2.1 Ownership

The ownership conditions in a firm determine different governance systems. For example:

1. Family-owned firms (family-firm governance)
2. Cooperatives (cooperative governance)

3. Nonprofit organizations (NPO governance)
4. Government agencies (public governance) and
5. Public listed companies (corporate governance in the narrow sense)

### **1. Family-Owned Firms (Family Business Governance)**

Family-owned firms, which constitute 85 % of all firms in the OECD countries, can be characterized by the intersection of the interest groups included in Fig. 2.13. The typical entrepreneur often fulfils the function that represents all four interest groups: as primary owner, head of the family, chairperson of the board and CEO (the area shaded in black; see Zafft 2002, p. 18).

But there are obviously a multitude of different forms that family businesses can take (Neubauer and Lank 1998, p. 15): “Approximately one-third of the 1,000 largest companies in the world are controlled by the families. Of those, half are traded publicly and half are privately held.” (Ward 2005, p. 10).

Davies suggests that governance advice to family-owned businesses must take into consideration the level of development of the business:

- “A first generation business may only require a small, informal advisory board rather than a board of directors
- when a family is small enough for all adult members to meet regularly ... all the family needs is a family council (in the second generation)
- a third generation family may even need a family assembly to bring together the members of the family annually to learn about and discuss the family business, plus a family council to help develop policy for the family.” (Davis 2003, p. 11)

In Switzerland, firms that are not publicly traded are under no legal obligation to include non-family members on their board. In those cases, the board functions exclusively as a representative (or administrative) board (Schmid 2002, p. 7), which fulfils its legal and statutory functions:

- Selection of top management
- Appointment of auditors
- Holding an annual board meeting and
- Holding an annual general assembly for approval of dividend distribution

“Familyness” (Muehlebach 2004) can be a competitive advantage compared to public companies dependent upon good family business governance: “It is their commitment to family unity that motivates them to be effective owners and support their business for the long term.” (Ward 2005, p. 10).

Schneider (Schneider in Schmid 2002, p. 12 ff), a successful entrepreneur, pointed out the following possible weaknesses of such firms:

- “The boss knows everything and can do everything better; he has an opinion about everything and tolerates no contradiction.
- Yes-men are in such cases over-represented in the management team.

- Earlier successes results in self-satisfaction.
- Earlier accumulation of reserves result in a false sense of security.
- Old recipes for success are used repeatedly in spite of changing circumstances.
- Blood ties or friendship sometimes substitute for professional competence.
- The interests of the owners, family and firm are not clearly distinguishable.
- As the money comes from his own pocket, the humble entrepreneur demands too little from his management and collaborators; or the self-assured entrepreneur, oriented towards appearances, removes from the company the liquidity which could be needed to revitalize or modernize the firm.
- No one knows exactly where money can be made or lost. The question ‘why’ is never asked.
- The delineation between strategic and operational activity is even more blurred than usual.
- Pragmatism rules, and planning is put-down as ‘scientific claptrap.’
- [And] disputes over power and influence among the owners can paralyze the firm and poison the atmosphere.”

Many successful humane entrepreneurs (with “cool heads, warm hearts, and working hands”) attempt to distribute roles in a timely manner to reflect the interest groups depicted Fig. 2.13.<sup>12</sup> According to Schneider (Schneider in Schmid 2002, p. 12 ff), a family-owned business should recognize the value of the following roles on the board:

|                  |                                                                                    |
|------------------|------------------------------------------------------------------------------------|
| Compensator role | (to provide otherwise lacking know-how)                                            |
| Evaluator role   | (to identify and overcome firm blind spots)                                        |
| Provocator role  | (as a thorn in the flesh of self-satisfaction)                                     |
| Promoter role    | (for the constant promotion of professionalism)                                    |
| Monitor role     | (for realistic self-evaluation)                                                    |
| Initiator role   | (as champion of constant change)                                                   |
| Conservator role | (as protector of justified continuity)                                             |
| Prospector role  | (to ensure prudent, ongoing strategy, financial and investment planning)           |
| Defender role    | (to protect the long-term interests of the firm against abusive actions by owners) |
| Moderator role   | (for solving conflicts between family owners, board members and management)        |
| Controller role  | (for monitoring and implementing the board’s decisions)                            |

In the following paragraph, we depict for illustration a real-life example from our experience.

<sup>12</sup> Kwak (2003) finds that firms in which families own 30 % or less tend to outperform other firms, whereas higher levels of ownership can lead to conflicts of interest and “expropriation” of wealth. She endorses the benefits that family businesses can reap from including independent directors on their boards, and from diversifying their investments so that family members do not necessarily go into management in any one particular firm.

### Illustrative Case Study for Part 1: Keep it Situational

(All names and dates have been changed in this “living” case)

Max Meier (61), a “humane” entrepreneur (with a cool head, a warm heart and working hands), succeeded his father as Baker in 1967 in Appenzell, Switzerland, and has over the last 35 years developed the family business into an internationally successful group of companies renowned for its chocolate specialties.

In 2002, the consolidated annual turnover reached €250 million. The group of 7 firms, employing 670 people, were acquired by Max Meier over a twenty year period.

Max Meier does not have any designated successor. He is owner, Chairperson, President, CEO and head of the family. His personality is characterized by a rare combination of entrepreneurial flare, creativity, sales talent and high moral standards. His wife, the only other member of the board, is the financial manager. Together with Max, the couple constitute an ideal private and professional partnership.

Max and his wife have four children:

- Max junior (36) completed an apprenticeship in pastry-making and then finished a law degree at the University of Geneva. Now he is responsible for exports in the firm and is based in Geneva.
- Monika (34), a Professor of Sociology at the University of Constance, resides in Kreuzlingen (in the north-west corner of Switzerland).
- Freddy (32) has a master’s in finance from the Wharton School and is CEO of the Schocko chocolate manufacturing company (acquired two years ago), one of the most successful sweets manufacturers in Entlebuch, Switzerland.
- Nicole (28) is an artist based in Paris. After her fine arts degree, she sojourned in Florence and Paris and furthered her studies in Vancouver and Rome.

Six months ago, Max Meier suffered a heart attack. He now asks you, as a competent, trustworthy and old friend, how he should confront the issues of board composition and management appointment.

How would you advise him?

“Families need corporate governance both to operate the business and to promote family harmony. This means putting in place decision making and monitoring procedures that are open and fair, as well as possibly hiring non-family members as advisors, managers and directors.” (Zafft 2002, p. 19).

A best-practice example is offered by HILTI in Schaan, a family-owned business and world leader in fastening systems, lead by Michael Hilti (son of the founder). Michael Hilti soon became aware of the fact that “the board of a family-owned

business should not be [only] a body mandated by law, but a committee that really supports the business.” (Hilti cited in Schmid 2002, p. 7 f, cf Navarro et al. 2009).

Michael Hilti is the only family member, the chairman of the family trust and the business owner. In those capacities, he is a member of a small, professionally structured, goal-oriented board. This board, in turn, leads and controls a professional management team made up of competent non-family members.

If “familyness” is a competitive advantage (as in the case of HILTI) or a competitive disadvantage, can be determined by filling out the following questionnaire which has been developed by Mühlebach (see C. Mühlebach 2004).

If the profile is located on the right hand side (as in the case of HILTI), “familyness” is a competitive advantage. If the profile is located on the left hand side, “familyness” is a competitive disadvantage.

|                                                                                                                                                        |                                                                                                          |  |  |  |  |  |                                                                                                                                          |
|--------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|--|--|--|--|--|------------------------------------------------------------------------------------------------------------------------------------------|
| <p>How does the family's influence, tradition, structure and philosophy impact the resources of the business?</p> <p style="text-align: center;"> </p> |                                                                                                          |  |  |  |  |  |                                                                                                                                          |
| <b>Physical Capital</b>                                                                                                                                |                                                                                                          |  |  |  |  |  |                                                                                                                                          |
| <b>Location and real estate</b>                                                                                                                        |                                                                                                          |  |  |  |  |  |                                                                                                                                          |
| Location                                                                                                                                               | disadvanta-<br>geous<br>(i.e. holding on to<br>an unfavorable<br>location out of<br>tradition)           |  |  |  |  |  | advantageous<br>(i.e. prime business<br>location, unique<br>physical distribu-<br>tion network, pio-<br>neer advantages)                 |
| Real<br>estate                                                                                                                                         | unattractive<br>(i.e. capital tied<br>up in real estate<br>not essential for<br>company opera-<br>tions) |  |  |  |  |  | unique<br>(i.e. non-imitable,<br>historical, highly<br>symbolic buildings)                                                               |
| Access<br>to raw<br>materials                                                                                                                          | disadvanta-<br>geous<br>(i.e. restricted<br>access, cost dis-<br>advantages)                             |  |  |  |  |  | advantageous<br>(i.e. possession of<br>mineral resources,<br>transaction cost<br>advantages due to<br>long-established<br>relationships) |
| <b>Technologies and equipment</b>                                                                                                                      |                                                                                                          |  |  |  |  |  |                                                                                                                                          |
| Machinery                                                                                                                                              | outdated<br>(i.e. neglect of<br>the necessary<br>investment)                                             |  |  |  |  |  | state of the art<br>(i.e. higher flexibil-<br>ity due to own fab-<br>rication)                                                           |
| Plants and<br>equipment                                                                                                                                | outdated<br>(i.e. neglect of<br>the necessary<br>investment)                                             |  |  |  |  |  | state of the art<br>(i.e. unique factory<br>layout)                                                                                      |
| Technology                                                                                                                                             | outdated<br>(i.e. lack of in-<br>vestment, lack of<br>know-how)                                          |  |  |  |  |  | state of the art<br>(i.e. special pro-<br>duction process)                                                                               |

| <b>Financial Capital</b>    |                                                                                              |  |  |  |  |  |                                                                            |
|-----------------------------|----------------------------------------------------------------------------------------------|--|--|--|--|--|----------------------------------------------------------------------------|
| <b>Financing</b>            |                                                                                              |  |  |  |  |  |                                                                            |
| Capital structure           | inadequate<br>(i.e. insufficient leverage)                                                   |  |  |  |  |  | advantageous<br>(i.e. flexible, high creditworthiness)                     |
| Cost of equity              | high<br>(i.e. high interest and dividend claims)                                             |  |  |  |  |  | low<br>(i.e. "patient capital")                                            |
| Capacity for self-financing | low<br>(i.e. excessive dividend payments hinder growth and development)                      |  |  |  |  |  | high<br>(i.e. financial independence with regards to investment decisions) |
| <b>Investing</b>            |                                                                                              |  |  |  |  |  |                                                                            |
| Dividend policy             | immoderate<br>(i.e. excessive dividend payments surmount the necessary investments)          |  |  |  |  |  | moderate<br>(i.e. consequent reinvestment policy)                          |
| Investment horizon          | short-term<br>(i.e. orientation towards short-term results draws on the company's resources) |  |  |  |  |  | long-term<br>(i.e. transgenerational thinking)                             |
| Propensity to taking risks  | riskaverse<br>(i.e. lack of entrepreneurial thinking)                                        |  |  |  |  |  | ready to take risks<br>(i.e. family as venture capitalist)                 |

| <b>Human Capital</b>                         |                                                                                                                |  |  |  |  |  |                                                                                       |
|----------------------------------------------|----------------------------------------------------------------------------------------------------------------|--|--|--|--|--|---------------------------------------------------------------------------------------|
| <b>Active contribution of family members</b> |                                                                                                                |  |  |  |  |  |                                                                                       |
| Role model                                   | negative<br>(i.e. distrust, family conflict and intrigues, personal enrichment at the expense of the business) |  |  |  |  |  | positive<br>(i.e. mutual attachment, openness and trust, willingness to perform)      |
| Qualification                                | insufficient<br>(i.e. nepotism, incompetent family members in leadership positions)                            |  |  |  |  |  | excellent<br>(i.e. specific process knowledge and industry-specific experience)       |
| Transfer of knowledge and contacts           | neglected<br>(i.e. lump risk, sole concentration of knowledge and contacts onto the entrepreneur)              |  |  |  |  |  | excellent<br>(i.e. mentoring, passing on of implicit knowledge and relevant contacts) |
| <b>Behavior towards employees</b>            |                                                                                                                |  |  |  |  |  |                                                                                       |
| Leadership                                   | self-righteous<br>(i.e. authoritarian, autocratic, arbitrary, intransparent)                                   |  |  |  |  |  | participatory<br>(i.e. team-oriented, involving)                                      |
| Working climate                              | demotivating<br>(i.e. characterized by distrust and control)                                                   |  |  |  |  |  | motivating<br>(i.e. familiar atmosphere, mutual support)                              |
| Continuity                                   | low<br>(i.e. lack of development and promotion prospects)                                                      |  |  |  |  |  | high<br>(i.e. shared identity, loyalty, constant contact partners towards customers)  |

| <b>Organizational Capital</b>   |                                                                                         |  |  |  |  |  |                                                                                              |
|---------------------------------|-----------------------------------------------------------------------------------------|--|--|--|--|--|----------------------------------------------------------------------------------------------|
| <b>Structures and processes</b> |                                                                                         |  |  |  |  |  |                                                                                              |
| Organizational structure        | bureaucratic<br>(i.e. centralistic, inflexible, hierarchical)                           |  |  |  |  |  | flexible<br>(i.e. federalistic, adaptable, flat hierarchies)                                 |
| Communication                   | uncommunicative<br>(i.e. deliberate hold back of information, intransparency, distrust) |  |  |  |  |  | open<br>(i.e. permanent, informal communication, open dialogue with all stakeholders)        |
| Dealing with conflicts          | destructive<br>(i.e. escalating conflict, conflicts are put under taboo)                |  |  |  |  |  | constructive<br>(i.e. constructive criticism, search for solutions)                          |
| <b>Corporate culture</b>        |                                                                                         |  |  |  |  |  |                                                                                              |
| Corporate culture               | agency-culture<br>(i.e. control-culture, motivation mainly through monetary incentives) |  |  |  |  |  | stewardship-culture<br>(i.e. trust, intrinsic motivation, culture of human entrepreneurship) |
| Norms and values                | diffuse<br>(i.e. unclear values, lack of vision)                                        |  |  |  |  |  | clear<br>(i.e. deeply-rooted values, values and norms are lived up to)                       |
| Readiness for change            | low<br>(i.e. perceptive filter, strategic rigidity, backward-looking)                   |  |  |  |  |  | high<br>(i.e. forward-looking, entrepreneurial orientation)                                  |

## 2. Cooperatives (Cooperative Governance)

Until recently, cooperatives have been treated with little interest or even contempt in research, teaching and practice. Only recently, researchers (Voiakina 2003 and Eckart 2003) have shown that cooperatives possess attributes which are extremely promising for many organizations (see also Merrett and Walzer 2004).

A cooperative is “an autonomous association of persons: united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.” ([www.ica.coop/ica/info/enprinciples.html](http://www.ica.coop/ica/info/enprinciples.html), cited in Eckart 2004, p. 1).

The International Cooperative Alliance, who propose the above definition of co-operatives, also propose the following principles for cooperatives:

1. “voluntary and open membership
2. democratic member control
3. member economic participation
4. autonomy and independence
5. education, training, information
6. co-operation among co-operatives and
7. concern for community.” ([www.ica.coop/ica/info/enprinciples.html](http://www.ica.coop/ica/info/enprinciples.html), cited in Eckart 2004, p. 1)

A central challenge facing boards of cooperatives – in addition to offering general strategic direction and control – is “to ensure that cooperatives are not simply overrun by market forces, but take a proactive stance in the design of their future governance model.” (Eckart 2004, p. 3).

Cooperatives differ from listed companies essentially because the members of the cooperative are simultaneously customers, owners, members of the general public and employees. This facilitates the stakeholder orientation required in a highly diverse organization.

Another feature of cooperatives, is that the owners’ shares are usually non-transferable, and this results in a high degree of loyalty among the owners, the customers, the general public and the employees.

## 3. Non-Profit Organizations (NPO Governance)

Only recently has “non-profit governance” become the standard term for the directing and controlling functions of organizations acting for worthy causes.

“In contrast to conventional firms, in which economic goals are the main priority, the non-profit organization considers its economic function only as a basis for its activities. Organizations built around worthy causes subject themselves to a much more complex set of expectations, as is the case with cooperatives.” (NZZ-Kommentar Number 239, 2003, p. 10). It follows that non-profit organizations usually take the legal form of a foundation or an association, and pursue primarily ethical and charitable goals.

However, there are many regrettable occurrences, for instance “the unprofessional use of donations, overburdened management, irregularities in association

leadership.” (Voggensperger and Thaler 2003, p. 10). It is not unusual to witness a precarious “dependency between voluntary supervisory boards and professional management.” (Rhinow 2003, p. 15).

We should therefore be grateful that in some countries standards for corporate governance for non-profit organizations have already been developed so that charitable organizations “can be transparent in their dealings with the public, and generate trust.” (Voggensperger and Thaler 2003, p. 10).

#### **4. Public Organizations (Public Corporate Governance)**

In most cases, recommendations to public companies are derived from best practices in private firms.

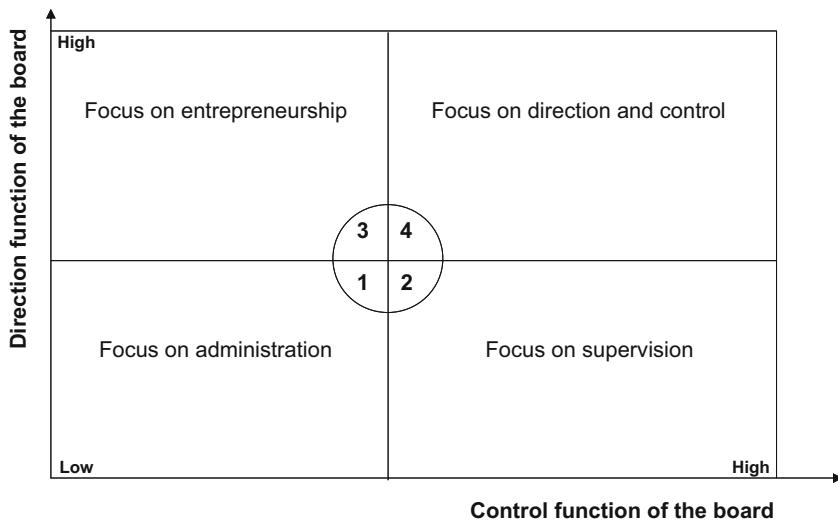
It is to Frey’s credit that he noted that “corporate governance can [also] learn from public governance.” (Frey 2003, p. 3). Agency theory, often discussed in connection with corporate governance, is exclusively focused on the activation of extrinsic motivation and negates intrinsic motivation factors. By contrast, in the public governance discussion, intrinsic motivation plays a central role. For instance, involvement and voting rights of employees at the board level, management responsiveness to different constituencies, the granting of titles as recognition and the clear distinction between executive and normative board functions are often features of public governance. An obvious challenge in public governance, though, is maintaining the delicate balance between political influence and management effectiveness (Schedler in Noetzli 2004, p. 26).

#### **5. Publicly Listed Companies (Corporate Governance)**

Corporate governance research and teaching concentrates almost exclusively on publicly listed companies. The same is true for the OECD guidelines and most national best-practice recommendations.

Before we address this group of companies in more detail in the following sections, we should clarify what such companies can learn as far as direction and control are concerned:

- From family-owned businesses (family-based governance), the meaning of the entrepreneurial designing function of boards
- From cooperatives (cooperative governance), the commitment to simultaneously address the needs of customers, owners, employees and the public
- From non-profit organizations (NPO governance), the meaningfulness and the ethics of doing and
- From public organizations (public corporate governance), the emphasis on intrinsic motivation as primary action motivator (following the motto: immaterial factors pre-eminent, material factors appropriate)



**Fig. 2.15** An illustration of different development levels of boards that are based on the different board systems mentioned below

### 2.2.2 Board Configuration

Different board configurations or orientations can be identified, according to the distribution of power.

#### The “Trial” Board System

In some socialist and Islamic countries, there exist (according to the author) the so called “trial” board system (see Fig. 2.16).

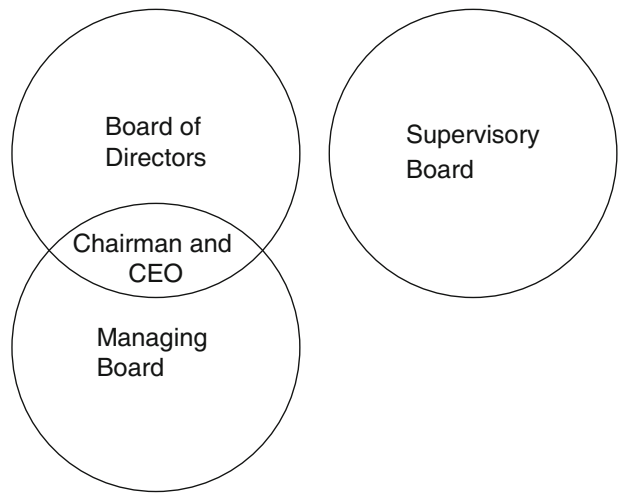
The role of the Board of Directors e.g. in China and Vietnam focuses on direction and the role of the Supervisory Board (determined by the ruling Party and the State) focuses on controlling. In Islamic Banks, the role of the Supervisory Board (which is composed of Imams) focuses on Ethical Guidance.

#### The “Dual” Board System

In some countries (Germany, the Netherlands, Poland, Slovenia and Indonesia, for example), the “dual” board system is used (Fig. 2.17). Its main characteristic is that the members of the managing board (in Germany, known as the *Vorstand*) are not allowed to sit on the supervisory board (the *Aufsichtsrat*).

The advantage is that there is a balance of power. The disadvantage is that political power struggles can result, and such power struggles can be detrimental to the long term competitiveness of the firm.

**Fig. 2.16** The “trial” board system (e.g. in China, Vietnam and Islamic Banks)



**The “Monistic” Board System**

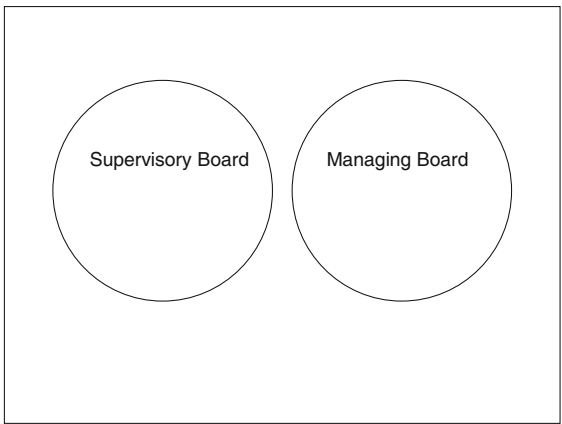
In most countries a “monistic” board system (Fig. 2.18) is used. This means that the supervisory board includes members of the management team.

Two types of “monistic” boards can be identified:

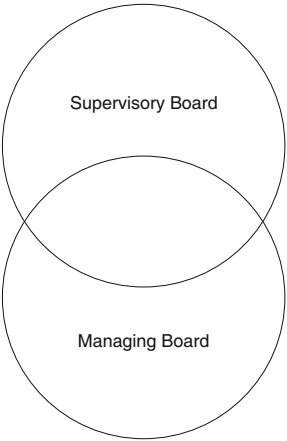
- **The executive board model** (Fig. 2.19) (used in many family-owned businesses, where most family members are simultaneously members of both the supervisory and managing boards.)
- **The non-executive board model** (Fig. 2.20) (predominant in the United States, where the majority of board members are external and independent.)

These two traditional models present a risk of power concentration with the CEO and a lack of critical feedback from stakeholder groups.

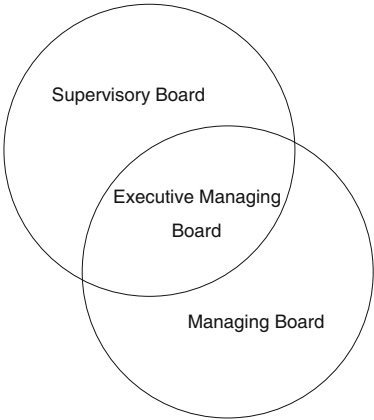
**Fig. 2.17** The “dual” board system (e.g. in Germany): a focus on supervision



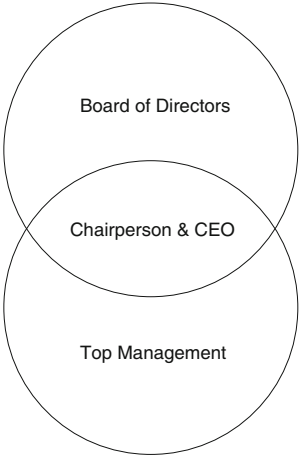
**Fig. 2.18** The monistic system (e.g. in Switzerland, though in Switzerland the dual system is possible, even compulsory for banks)



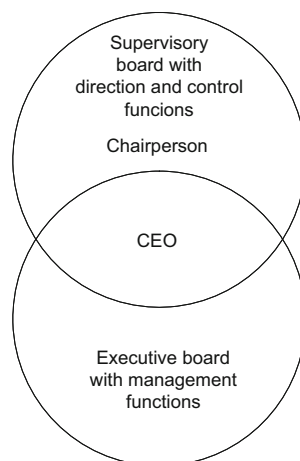
**Fig. 2.19** The executive board model: a focus on entrepreneurship (in many family companies)



**Fig. 2.20** The non-executive board model: Focus on administration



**Fig. 2.21** Direction and control board model



Supervisory boards are often purely “administrative,” meeting because the law requires it. To overcome the limits of these models, the additional function of lead director was introduced. The lead director is an independent personality who chairs the board’s meetings when the chairperson and CEO are the same person, and when the issues at stake constitute a conflict of interest for that person.

### **The Third Way: The Board as a Mechanism for Direction and Control**

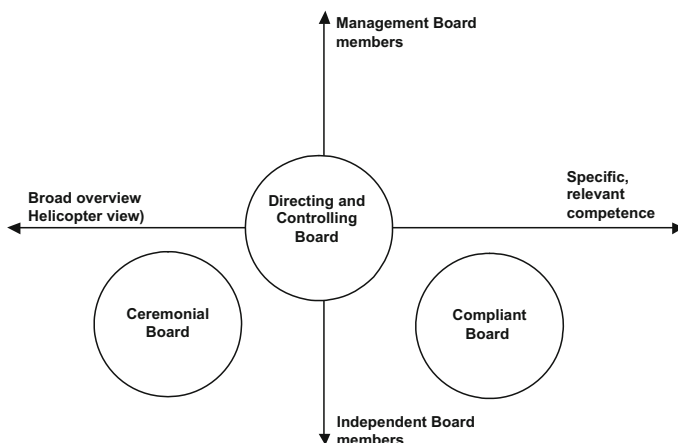
This model addresses the requirements of the latest international (e.g. *OECD Principles*, 2004) and national efforts (e.g. “King III” report, 2009; *Combined Report*, 2009; *Economiesuisse Recommendations*, 2014).

The direction and control model (see Fig. 2.21) includes so called “Privatissimo Sessions”, i.e. before each meeting of the supervisory board an informal session takes place among all independent board members excluding the CEO where all issues are discussed where it would be a conflict of interest if the CEO would participate.

The majority of board members including the chairperson should belong to a “... class of totally independent directors who have no vested interests.” (Vermeulen 2002, p. 20).

In practice, the board should not comprise (Malik 1998, p. 171):

- More than two members of senior management (ideally only the CEO should represent management)
- Persons who have an active business relationship with the firm (such as suppliers, customers, vendors, consultants and auditors)
- Representatives of the main source of debt funding
- People responsible for too many board mandates
- People who do not have enough time or
- People who do not have any firm-relevant know-how



**Fig. 2.22** A board composed for direction and control

The “King II” report suggests: “Where the roles of chairperson and CEO are combined, there should be either an independent non-executive director serving as deputy chairperson or a strong, independent, non-executive director element on the board. Any such decision to combine roles should be justified each year in the company’s annual report.” (King II report, in Business Report 2002, p. 8).

The limits of such recommendations should not be underestimated, however. They can improve governance conditions, but such conditions are not in themselves sufficient to attain success or avoid crisis. Even when the functions of chairperson and CEO are separate, much hinges on the relative power of the players (for example, at UBS, Ospel vs. Arnold; and at SAir Group, Burgisser vs. Goetz). In spite of the separation of positions, necessary checks and balances are often missing.

The chairperson plays a central role. She or he “works with and through a chief executive and evidences a ‘hands-off’ managerial style, coupled with open and warm personal relationships that extend to board members. Objectivity, experience, vision, sensitivity and purposeful style are the hallmarks of this profile and capture the elements of being both an outsider and an insider. This chairperson regards his/her role as one of facilitation, unity and commitment and avoids competition with his/her executive.” (Bendixen and Thomas 2000, p. 69).

The chairperson has the task of ensuring the right mix of people on the board (see Fig. 2.22). Ideally, he/she will lead a directing and controlling board.

The lowest board development level would be a ceremonial board (chaired by an all-powerful Chairperson and CEO).

The current dominant board development level in many countries is the compliant board (which is only based on legal compliance).

According to one American chairperson, in the future, the art of being a good chairperson will involve “having your nose in and your hands out” of company business.

An investigation by McKinsey & Co. reported that “institutional investors would pay heavy premiums (in some cases, nearly a third more) for well-governed emerging market companies compared with less transparent, more dishonest entities, even if financial performance was similar.” (Vermeulen 2002, p. 20).

The multiplicity of national and international standards notwithstanding, Böckli suggests that the core issues can be defined as (Böckli 2001, p. 9 ff):

1. The confusion of the roles and responsibilities of the supervisory board and the managing board
2. Unclear definition of what the controlling function of the board really means (“after one has tried for so many years to separate the controlling function – namely internal auditing – as a special management task distinct from every other function.”)
3. The danger of creating the board, and particularly the audit committee, as a purely administrative function
4. The danger of requiring too much from board members
5. The danger of requiring too much from audit committee members
6. And the danger of risk avoidance and a lack of entrepreneurial spirit in boards

Besides the power balance between and within the supervisory and managing boards, the complexity of the organization is a further defining characteristic of corporate governance practice.

### 2.2.3 Organizational Complexity

In organizational complexity, we distinguish between:

- (A) Organization size
- (B) Stage of development

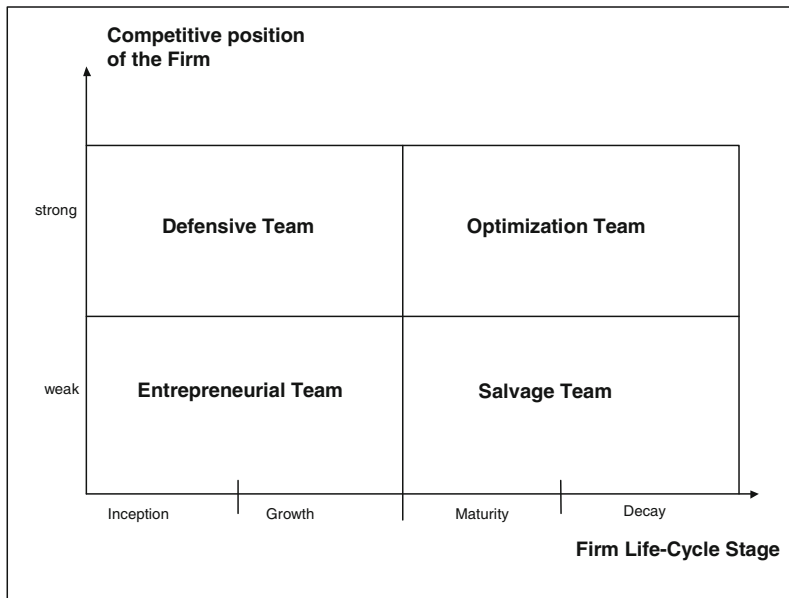
#### (A) Organization Size

Ideally, boards in small firms should have three members; boards in medium-sized firms, five; and large firms, seven. In most cases, boards with more than eight members are hard to manage. For instance, when a lunch for nine guests takes place, sub-groups will automatically emerge and interact with one another; it is not possible for each guest to interact with all the others.

The absolute number of members of a board is dependent upon only one factor, however. Of more importance is the complexity of the know-how, roles and social characteristics of the board.

#### (B) Stage of Development

The board and management of a firm should be comprised and structured differently, depending on the stage of development of the firm (Fig. 2.23).



**Fig. 2.23** Leadership requirements based on stage in firm life-cycle. (Laukmann and Walsh 1986, p. 95)

We need to take into consideration the fact that:

- A clear delineation of the individual phases is not always possible
- The sequence of the stages of the firm life cycle is not always followed
- And firm development can be influenced by board and management interventions (Elsik 1992, p. 139)

This stage will be discussed further in Sect. 2.1.

## 2.2.4 Board Role Players

At board level, the following role players can be distinguished:

1. Chairperson of the board
2. External/independent board members and
3. Board secretary

### 1. Role of the Chairperson of the Board

Malik suggests that it is the chairperson who leads the board and the firm to success, increased value and accountability (Malik in Noetzli 2004, p. 50). The most important role of the chairperson is to guarantee that “boards provide the leadership

(and control) which is expected of them.” (Cadbury 2003, p. 34). Thus, professional leadership of board meetings is one of his or her most important tasks. “The resource which chairmen have to handle is the time and the talent of their board members.” (Cadbury 2003, p. 80).

Malik also suggests that competent chairpersons seek consensus on issues facing the board, but that they do so by using unconventional approaches: systematically teasing out dissension in the conviction that truly robust consensus emerges from an exploration of different opinions (Malik in Noetzli 2004, p. 50).

The meeting location is also of importance: “for chairpersons to be in control, they have to be in a position to see all participants, which is why I prefer round tables.” (Cadbury 2003, p. 80). In international companies, the professional use of video-conferences and web-cameras is of growing importance.

Cadbury recommends that the agenda be arranged in three subject areas:

1. Information on the company progress (according to top management): “periodic reports on sales, profits, shares of market and cash come under this heading,” (Cadbury 2003, p. 84) as would surveys of employees or other stakeholders
2. Matters requiring board decisions and
3. Other important discussions on “matters which need resolution, or on which the executives are looking to the board for guidance.”

It is important that “chairpersons normally refrain from expressing their views on an issue, until other board members have had the opportunity to express theirs.” (Cadbury 2003, p. 90). The position of chairperson requires “a talent for listening, for leading and for inspiring, and the time to do so.” (Cadbury 2003, p. 103).

It is also important “that the chairperson and the chief executive see their jobs as complementary not as competing . . . and that the two individuals have to establish trust in each other.” (Cadbury 2003, p. 117). Furthermore, the tasks, roles, competencies and responsibilities of the chairperson of the board should be described briefly and agreed upon, and then it should be assumed that “anything not included in that [agreement] was the responsibility of the [CEO].” (Cadbury 2003, p. 118).

In conclusion, it can be said that “chairpersons are there to orchestrate the discussion, so that it comes to a fruitful conclusion. The test is straightforward: how much of a board’s discussion time is taken up by its chairperson?” (Cadbury 2003, p. 241).

## 2. Role of the Independent/External Board Members

Ideally,<sup>13</sup> all members of the board (excluding the CEO and possibly one other member of top management) should be independent, in order to properly fulfill their

<sup>13</sup> “There appears to be overwhelming support among financial researchers for outside directors providing beneficial monitoring and advisory functions to firm shareholders . . . indicating that firm performance suffers if the proportion of independent outsiders is too low or too high” (Fields and Keys 2003, p. 5). See also the best-practice guidelines of the *Canadian Coalition for Good Governance*: “Define and report to shareholders, the responsibility of the chair; establish and report to shareholders, the annual review process for the chair; have the independent chair set board agendas with the CEO and be responsible for the quality of the information sent to directors;

functions.<sup>14</sup> Cadbury assumes that independent board members are “independent of management and free from any business and other relationship which could materially interfere with the exercise of their independent judgment.” (Cadbury 2003, p. 21).

The extensive British PIRC report suggests the following criteria for independent board members. “A board member:

- should not be a former executive
- should not be a professional advisor
- should not be a significant customer or supplier
- should not be appointed as a result of a personal relationship
- [should be] selected by a formal process
- should not stay on the board too long
- should not be a close relative to an executive/director
- should not be an employee
- should not participate in share option schemes
- should not be considered to have pensionable service
- should not represent a major shareholder
- should not have directorships in common with other directors
- [and] should not hold a position with a body that received donations.” (Clarke 1998, p. 122)

The British NAPF (National Association of Pension Funds) has the following standards for independent board members, focusing on what board members should be, have or do, rather than what they should not (Hasan 2002, p. 341):

1. “A willingness to contribute to strategy and to challenge executives on strategy and other matters, as necessary
2. a readiness to challenge the company’s mergers and acquisition policy
3. an ability to contribute to financial and capitalization issues
4. relevant experience for all the needs of the company’s business
5. independence of mind
6. individuals with sufficient time to devote to the needs of the business
7. integrity and preparedness to resign over matters of principle, should that be necessary
8. and a willingness to learn and continue to learn, not only about the business and its market sectors, but also about the role of the independent director.”

An additional mechanism by which board members’ independence can be strengthened is ensuring that they have a budgeted allowance for advice and development (see Dalton 2003, p. 43).

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require the chair to hold ... sessions of independent directors without management present, at every board meeting and every committee meeting” (Beatty 2003, p. 12).

<sup>14</sup> Here, it is important to differentiate between board membership and participation of top managers in board meetings. Often, it is valuable to invite participation of top managers to address agenda items in board meetings.

There is an important distinction between non-executive board members and independent board members. “All independent directors are non-executive, but not all non-executives are independent.” (Merson 2003, p. 13). Important shareholders can be non-executive, but not independent board members. “Their role is primarily to safeguard the interests of the venture capitalist, which often clash with those of the company.” (see Dalton 2003, p. 43).

The difference between executive and non-executive members can be defined as follows:

| Executive member       | Non-executive member             |
|------------------------|----------------------------------|
| – Dependent            | – Independent                    |
| – Full-time employment | – Part-time employment           |
| – Salaried employee    | – Contract or fee based pay      |
| – Internal know-how    | – External know-how              |
| – Hands-on             | – Hands-off (Merson 2003, p. 10) |

Sometimes exceptions to these rules can be important. For example, important shareholders can be board members if this is explicitly agreed upon by the other board members, and if they “disclose [any] potential conflict [of interest] and excuse themselves from the discussion in situations where there could be a conflict.” (Carter and Lorsch 2004, p. 97). The same goes for the selection of an executive board member other than the CEO. It may be valuable to elect as a board member a successful former CEO, someone who has served as chairperson of the board of another company more than four years earlier.

### 3. Role of the Board Secretary

The importance of the company secretary has been largely underestimated in research and practice (Cadbury 2003, p. 23 and 129). Therefore we recommend to call him/her “Corporate Governance Officer”. As compliance officer, the company secretary is not a board member, but is a partner in board and committee meetings.

“He or she must supervise due process under company law to ensure that ... the correct annual returns are made to the relevant authorities at the right times; the board follows proper procedure under its Memorandum and Articles of Association; board agendas are drawn up for board meetings; full minutes are kept; and minutes of board papers are circulated in a timely manner so that directors have time to read and absorb them; and ensure both their accuracy; and that appropriate actions are being taken by the executives.” (Garratt 2003a, p. 94).

“The other main project on which the chairman and the company secretary are likely to work together is the company’s annual report and accounts” (Cadbury 2003, p. 128) and making “the arrangements for the AGM.” (Cadbury 2003, p. 129).

### 2.2.5 Degree of Internationalization

The stages of internationalization can be grouped into four categories (Perlmutter and Heenan 1974, p. 121 ff):

#### Development Stage I

Ethnocentric composition of the board and management teams: a colonial approach.

This approach is often used at the beginning of the process of internationalization (as well as during times of crisis). The human resource policy of the head office will be applied in all domestic and foreign operations as a package. Both chairpersons and managing directors of the subsidiaries are home country expatriates. Even today, Japanese firms use this approach with very few exceptions (i.e. Sony). The advantages are visible primarily in the first phase of the firm's internationalization. In this first phase, in order to implement the head office strategy and HR policy congruently, responsibility for the creation of a new foreign subsidiary is delegated to an experienced member of the head office.

This approach should, however, be constrained in its use (at the beginning or in times of crisis), as the drawbacks accumulate in the long term. Aside from the fact that sending expatriates abroad results in very high transfer and remuneration costs, the danger of insufficient consideration being given to local markets and conditions is real. In that respect, there are numerous examples of Japanese multinational companies that used to use the ethnocentric approach. The best upper-middle managers were lost because their nationality precluded their being given full responsibility for local subsidiaries. These disadvantages are often the reason why, after a certain time on the international scene, many firms move on to the polycentric approach.

#### Development Stage II

Polycentric composition of the board and management team: a bilateral approach.

This federalist concept emphasizes the local autonomy of the subsidiaries when developing, producing and evaluating policy. All subsidiary board members and employees are recruited locally. Many US and European firms or groups of firms apply this approach. It will mostly be used in sectors where the contact of management with government and local administration is very important and can be better ensured by local managers.

The clear advantage of this approach is that it is the least expensive. The national needs of customers and employees are better taken into account, and at an international level, the advantage of a federalist umbrella organization can be better realized.

However, there are drawbacks: many firms using this approach have witnessed the secession of foreign subsidiaries from the global strategy of the head-office. Furthermore, this approach precludes one of the most important advantages of multinational companies over national ones: in such multinational firms, the development possibilities for board members and employees are as limited as those in national companies.

### Development Stage III

Regio-centric composition of the board and management team: a regional approach.

This approach derives from the emergence of a common European human resource management model. The idea is that in a Europe without borders, there should be a unified regional model of recruitment, evaluation, compensation and development of boards and human resources. This approach is applied by some multinational US firms that often have regional headquarters, for instance in Americas, Europe, Africa, the Middle East and Asia.

Firms that make use of a regional personnel policy gain access to borderless labor markets of large trading blocks (such as the EU and NAFTA) and can therefore establish a competitive advantage over solely national firms.

The drawbacks become manifest when global board and human resource potential cannot be optimally developed. A common false assumption is that unified economic spaces imply unified national cultures. My own consulting experience in 60 countries and the comprehensive studies of Hofstede (Hofstede 1991) have shown, however, that there is no such thing as a unified continental culture. There is no such thing as *a* European culture nor is there *one* Asian culture nor *a single* North American culture. Cultural differences between the UK and Greece are larger than those between the UK and New Zealand, for example.

The concepts I have presented this far can be classified as ethnocentric approaches:

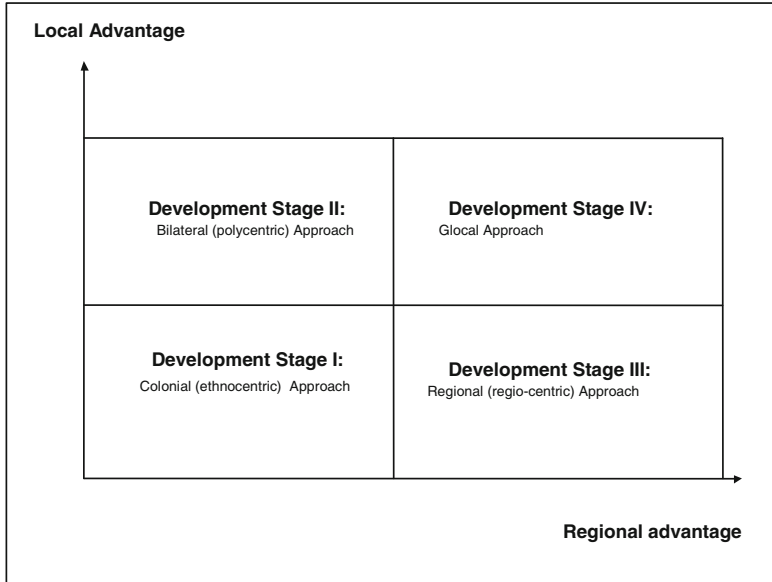
- Development level I embodies a pure ethnocentric approach
- Development level II is a subsidiary based ethnocentric approach
- And development level III is a regional based ethnocentric approach

Those three have in common a perspective which does not connect the comparative advantages of single approaches. Thus either the multicultural national differences (level II) or the regional commonalities (level III) will be overplayed or a “neither-nor” strategy (level I) will be followed. These three perspectives render impossible the advantages of the “both-and” approach of true multicultural board and personnel development (level IV in Fig. 2.24).

### Development Stage IV

Geocentric composition of board and management team as a *glocal* approach.

Only the geocentric approach attempts to integrate the firm and country cultural specificities and the national differences on the board and personnel management levels appropriately. This approach allows the development, introduction and evaluation of worldwide normative guidelines and systemic simplifications, with due consideration for strategic regional conditions and operative national peculiarities. This approach will be applied independently, regardless of the culture of the home office or of the industry, by some of the most successful transnational firms, e.g. British pharmaceutical concern, GlaxoSmithKline or Swiss food manufacturer, Nestlé. The drawbacks of this approach are the inordinately high transfer and com-



**Fig. 2.24** Stages in multicultural board and management development

pensation costs (e.g. attaining in some cases three times the level of a polycentric approach) and the potential personal risks associated with frequent relocations.

However, in the future, as the proportion of international business carried out by companies grows, the advantages of the *glocal* approach will increase in importance. These advantages are:

- Optimal use of international board and HR potential
- Better alignment of board and management teams of foreign subsidiaries with the global vision and strategies of the home office, simultaneously taking into consideration local conditions and strengths
- Development of a cosmopolitan learning-oriented corporate culture, in which a strong competitive synthesis of the comparative and transferable strengths of the different national cultures can be achieved
- And creation of attractive personal development possibilities for the board members and executives of the different national companies

As the advantages are limited to a relatively small portion of cosmopolitan, transfer-ready board members and managers, it will be advisable in future to apply a combined approach based on the priority and target group of the board and personnel management (see Fig. 2.25).

Board committees and corporate HR executives limit themselves to the participative development, introduction and evaluation of integrated board and HRM concepts. As usual, those concepts have to do with recruitment, appraisal, com-

| Priority    | Target group                                 | Approach      |
|-------------|----------------------------------------------|---------------|
| Normative   | Board and management team at home and abroad | Geocentric    |
| Strategic   | Transfer-ready project teams and managers    | Regio-centric |
| Operational | Employees (non-managerial)                   | Polycentric   |

**Fig. 2.25** Combined approach of multicultural board and HR management

pensation and development of board and management teams at home and abroad. Regional personnel managers have to effect the development, introduction and evaluation of the strategies passed down from the center, for managers and members of regional project teams. Local personnel managers concentrate on operational personnel concepts derived from the regional strategies to address the need of all local employees who do not want to be transferred abroad. Organizations exhibiting the following characteristics can be described as *glocal*: “global competitiveness, multinational responsiveness, and worldwide learning.” (Bartlett and Goshal 1989, p. 21).

How can firms become more *glocal*?

Globalization means that firms must confront themselves with increasingly complex competitiveness requirements regardless of their size. This applies also to virtual firms. Firms must learn to act with entrepreneurial flair in and between a large number of different cultures. The global agenda for such firms is to learn from each culture the best it has to offer, and to adopt and implement those best practices that are transferable.

Firms need what I call “*glocalpreneurs*,” managers capable of integrating global and local with integrity, leadership, management and entrepreneurial competence.

In other words:

- Not everyone who has an **appropriate personality** also has multicultural competence
- Not everyone who has **multicultural competence** also has management competence
- Not everyone who has **management competence** also has leadership competence
- Not everyone who has **leadership competence** also has entrepreneurial competence
- And not everyone who is **entrepreneurial** behaves ethically

But: someone who has all these qualities is a real *glocalpreneur*.

The board and top management team of a transnational firm, comprising *glocalpreneurs* with a spectrum of core competencies, could thus be described as a team of “transformational managers.” (Tichy and Devanna 1986, p. 271). According to Tichy and Devanna, “They describe themselves as change agents:

- they are courageous
- they believe in people
- they are value oriented
- they have a life-long learning orientation
- they can deal with complexity, ambiguity and uncertainty
- and they are visionaries.” (Tichy and Devanna 1986, p. 271)

Such a team of *glocal* and transformation-oriented board members and managers is an important prerequisite for the development of a corporate culture based on trust, the capability to (un)learn and personal and societal values (Konzes and Posner 1988).

### **Subsidiary Governance**

The US subprime crisis has created huge problems for most global banks.

What is the important lesson learned for Corporate Governance of Global Banks?

It is impossible for Audit Committees of complex global banks to direct and control operations and risks in all worldwide operations for example, by conducting 12 meetings per year.

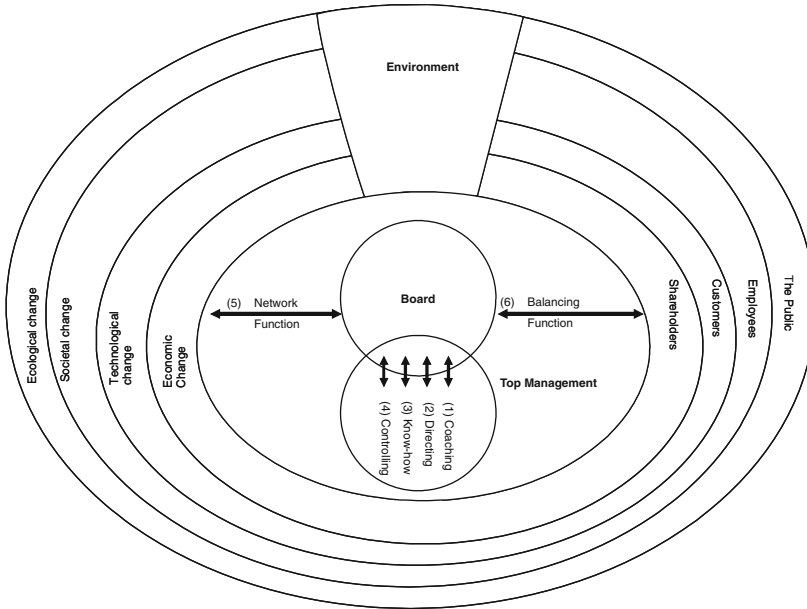
We suggest therefore to introduce for such complex global organizations (mainly in financial services) an overlapping subsidiary governance system as follows:

Instead of having so called puppet boards in most subsidiaries (who only search for local compliance), we recommend to compose in all main subsidiaries, a board team comprising of independent members with the same well diversified local know-how as the local management team possesses to direct and control the subsidiary operations and risks. The subsidiary board team is to be chaired by a member of the corporate or divisional board.

## **2.2.6 Mix of Board Functions**

Boards undertake the following tasks in many countries (Hung 1998, p. 101 ff, cf Huse 2008):

1. Selection, review, remuneration, development and sometimes the removal of the CEO (or other important members of the management team)
2. Co-development and evaluation of corporate strategy structure, and culture
3. Budget development and financial planning and control
4. Reporting to the shareholders and stakeholders
5. Board self-review



**Fig. 2.26** Board functions

Depending on the country, industry and firm culture, boards perform the functions illustrated in Fig. 2.26 in different proportions:

1. Coaching
2. Directing
3. Knowing
4. Controlling
5. Networking and
6. Balancing

Based on an analysis of most board roles, the directing and controlling functions of boards are central in the corporate governance discussion. Thus, depending on the context, a different mix of functions is chosen, as depicted in Fig. A.1 in the foreword. In that illustration, quadrant 1 (the board as an administrative function) is usually chosen by firms that do not want to have external direction or control; quadrant 2 (the board as a supervisory function) corresponds to the German model of governance; quadrant 3 (the board as an entrepreneurial function) is chosen most often by pioneer firms; and quadrant 4 (the board as a directing and controlling function) is aimed at by Swiss hard and soft laws.

Based on the contextual factors described above, a highly differentiated representation of board practices emerges around the world (Fig. 2.27).

| Country       | Shareholder vs. Stakeholder Perspective of Boards | Monistic vs. Dual Board-System | Geo vs. Ethnocentric Board Composition (at least 1 foreigner on the Board) | Proportion of firms separating roles of Chairperson and CEO | Proportion of external Directors on the Board | Employee representation on the Board | Ø Board Size | Board Function |         |
|---------------|---------------------------------------------------|--------------------------------|----------------------------------------------------------------------------|-------------------------------------------------------------|-----------------------------------------------|--------------------------------------|--------------|----------------|---------|
|               |                                                   |                                |                                                                            |                                                             |                                               |                                      |              | Direction      | Control |
| USA           | SH                                                | M                              | E (24%)                                                                    | 15%                                                         | 77%                                           | None                                 | 13           |                | X       |
| Canada        | SH                                                | M                              | E (25%)                                                                    | 66%                                                         | 80%                                           | None                                 | 12           | X              | X       |
| Brasil        | SH                                                | M                              | E (10%)                                                                    | 20%                                                         | 60%                                           | None                                 | 6            |                | X       |
| Australia     | SH                                                | M                              | E (1%)                                                                     | 70%                                                         | 75%                                           | None                                 | 8            |                | X       |
| Japan         | ST<br>(excludes SH)                               | M                              | E (0%)                                                                     | 100%                                                        | 5%                                            | None                                 |              |                | X       |
| France        | SH / ST                                           | M / D                          | E (62%)                                                                    | 0%                                                          | 82%                                           | Yes, (minority)                      | 13           |                | X       |
| Germany       | SH / ST                                           | D                              | E (34%)                                                                    | 100%                                                        | 100%                                          | Yes (parity)                         | 15           |                | X       |
| Italy         | SH                                                | M                              | E (40%)                                                                    | 100%                                                        | 73%                                           | None                                 | 11           |                | X       |
| Great Britain | SH                                                | M                              | E (40%)                                                                    | 90%                                                         | 50%                                           | None                                 | 9            | x              | X       |
| Netherlands   | SH / ST                                           | D                              | E (38%)                                                                    | 100%                                                        | 100%                                          | None                                 | 7            |                | X       |
| Switzerland   | SH / ST                                           | M                              | E (59%)                                                                    | 63%                                                         | 89%                                           | None                                 | 9            | X              | x       |

**Fig. 2.27** International comparison of board characteristics. (Pic 1997, p. 18)

There is certainly no single corporate governance template for international companies (Pic 1997, p. 34). However, the globalization of capital markets, dominated by the UK and United States, is forcing a sort of convergence.

In this book, we have referred to *glocal* corporate governance. In other words, for the parent company and the boards of subsidiaries, there is convergence towards a corporate governance model:

- Both a small directing and controlling board (ideally comprising seven members), and a larger non-accountable network/advisory board (including members of the different constituencies)
- Taking into consideration both the interests of the shareholders as well as those of customers, employees, and society
- Both a monistic system and, if necessary, a dual system (in banks for example)
- Both a geocentric and a polycentric approach to appointing the supervisory and managing boards
- Both insiders and external independent members sitting on the supervisory board
- Both a directing and a controlling function and
- Both generalist competences (entrepreneurial and leadership competences developed in other firms) and specialist competences (in auditing, risk management and HRM, for example)

It is important to observe not only the global OECD guidelines ([www.oecd.org](http://www.oecd.org)), but also the best practice soft law established in many countries ([www.ecgi.org](http://www.ecgi.org) see “Codes & principles”)

- In North America, e.g. the “DEY” report in Canada
- In Asia, e.g. the “Bosch” report in Australia
- In Africa, e.g. the “King III” report in South Africa
- In Europe, e.g. the “Combined” report in Great Britain

In addition, it may be advantageous to prepare a board charter (or a “Board Magna Carta”<sup>15</sup>) setting out the specific requirements of board members of a particular firm:

- “To request that a vote be taken in a particular manner (roll call, show of hands, voice or secret ballot)
- to request added information on any subject brought before the board and to personally question anyone who presents to the board before a vote is called
- to request changes to the minutes before their approval and have changes made that accurately reflect what actually happened
- to have personal opposition to an item passed by majority vote be reflected in the minutes<sup>16</sup>
- to move to defer action on any item of business to a later date (this, of course, must still be approved by a majority vote) and
- to request a summary of internal policies and procedures that the board has developed through its history.”<sup>17</sup>

Having dealt with the firm external and internal contexts in this chapter, we turn to the strategic dimension of the firm in Chap. 3.

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<sup>15</sup> Ward (2003, p. 22) cites a practical example developed by Young.

<sup>16</sup> This being of considerable importance in any subsequent legal proceedings.

<sup>17</sup> Young’s practical example, cited in Ward (2003, p. 22).

New Corporate Governance

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