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CORPORATE GOVERNANCE FAILURES – CAUSALITY AND CONSEQUENCES[1]

Abstract: *The article describes the importance of corporate governance in business for the countries and individual companies; it deals with corporate governance failures and weaknesses (renumeration/incentive systems, risk management practices, the performance of boards, and exercise of shareholder rights) before the economic and financial crisis and opportunities for its improvement. The authors present the implementation of corporate governance principles in business sphere as a very important incentive for foreign investor's decisions and for influencing the quality of business environment. The paper deals with the corporate governance principles and influence on the increasing of level of competitiveness, law, regulations, and with acceptance of the importance of control mechanism (audit, rating – misleading or misused, shareholders, stakeholders, and gatekeepers). Further, authors deal with the prevention of the failures of corporate governance (paying attention to good and bad growth) company support to constructive engagement with their shareholders, with the adequacy of corporate governance principles in excessive risk taking, in accounting standards and regulatory requirements and in remuneration systems, and reflect on the importance of qualified board oversight. The authors consider the causes of the global economic crisis, which they see as a crisis of confidence and are trying to find some links between the causes of the crisis and the lack of corporate governance.*

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Introduction

Corporate governance is a frequently used phenomenon, but the first activities in this sphere could be traced three or four decades back. The term "corporate

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governance" appears to have arisen and entered into prominent usage in the mid-to-late 1970's in the USA in the wake of the Watergate scandal and after the discovery that major American corporations had been engaged in secret political contributions and corrupt payments abroad. Eventually, it also gained currency in Europe as a concept distinct from corporate management, company law or corporate organisation. Many definitions focus not only on the formal rules and institutions of corporate governance, but also on the informal practices that evolve in the absence or weakness of formal rules. These activities were concentrated on improvements in board practices and did not contain any references to "governance". Discussion of board practices increased in the late 1970s and early 1980s with three important projects by the Business Roundtable, The American Bar Association and the American Law Institute. The Business Roundtable issued a statement entitled "The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation" (followed later with the issuance by the Section of Corporation, Banking and Business Law of the American Bar Association of its "Corporate Director's Guidebook" which expanded through the publication of "The Overview Committees of the Board of Directors". In 1982 the American Law Institute began to issue drafts of what is now called "Principles of Corporate Governance: Analysis and Recommendations". Since then a huge amount of principles, books, and researches have come into being.

The purpose of this article is to show the connection of non-compliance and failure of corporate governance in companies and public governance at national level with the development and deepening of the financial and economic crisis and the sharp decline in confidence in integration processes, government, financial institution, banks, and in transnational corporations.

"Corporate governance is a relatively recent concept. Over the past decade, the concept has evolved to address the rise of corporate social (and environmental) responsibility and the more active participation of both shareholders and stakeholders in corporate decision making. As a result, definitions of corporate governance vary widely, while two categories prevail. The first one focuses on behavioural patterns – the actual behaviour of corporations, as measured by performance, efficiency, growth, financial structure, and treatment of shareholders and other stakeholders. It considers such issues as how boards of directors operate, the role of executive compensation in determining firm performance, and the roles of multiple shareholders and stakeholders. The second one deals with the normative framework – the rules under which firms operate, with the rules coming from such sources as the legal system, financial markets, and factor (labour) markets. Both definitions include corporate social responsibility and sustainability concepts. The second type is more relevant for comparative studies. It investigates how difference in the normative framework affects the behavioural patterns of firms, investors, and others." ([1], p.3)

Corporate Governance Failures and Crisis

In order to abide by the rules of corporate governance several companies have

appointed also “Chief Governance Officers” and yet, there is still some confusion about what these officers do. There is a disparity between what these officers actually do, as practice depends on the company’s circumstances. Moreover, there is also great disparity between what is “written” in the corporate governance code and corporate governance practices „done” (controversy between perception and reality). Every year there are great figures of corporate fraud convictions which include convictions of chief executive officers, corporate presidents and chief financial officers (false transactions recorded, earnings overstated, inflated earnings – hidden debt in special purpose entities to keep losses off the company’s balance sheet, improper share deals, expenses booked as capital expenditure, and accelerated revenue recognition). The creation of corporate regulation is often linked to perceived failures of corporations and their management to behave in the way society expects them to.

“The crisis has opened the old debate about the costs and benefits of regulation as opposed to market mechanisms. However, there have also been instances of regulatory failure even in the most regulated sectors. In a number of cases, it is now apparent that even amongst what were regarded as properly resourced and empowered regulators, there were significant deficiencies. In most jurisdictions, corporate government codes are used as a means for seeking to encourage companies to introduce standards and practices of corporate governance that go further than law and regulations. The danger often pointed out is that implementation might be only formal and the reliance on market participants for enforcement might be weak in those jurisdictions where active investors do not have a strong presence, interest or incentive, or where corporate control is highly concentrated. In a number of jurisdictions, an oversight/monitoring body has been established to monitor the application of the code and to propose revisions, and this appears to help underpin the relevance of the codes. In those jurisdictions where voluntary codes specify corporate governance outcomes, such as board behaviour and composition, which complement or go beyond laws and other public regulation, it is important that adequate monitoring and compliance mechanisms are provided to ensure their effective implementation and timely update” ([2], p. 7).

The problem of corporate governance is the daily internal operations that take place in an enterprise. This is a good task for Chief Governance Officer to act as a problem solver (in advance). The person filling this position must have a reputation of uncompromising integrity and have an influence on all corporate departments. Deloitte Touche Tohmatsu Limited had developed a unique global learning tool called “The Integrity Compass” in which ethical dilemmas are used to show the subject and importance of ethics in the workplace – appropriate for all levels and functions in the firm:

– Tone at the Top – leadership responsibility, accountability, and behaviour;
– Infrastructure (processes, systems, organisational structure to sustain ethical behaviour);
– Competence (selection and development of people/leaders that subscribe to our standards of ethical behaviour).

Corporate governance must be consistent and sustainable. Free market ideology was that corporations were held responsible to customers, shareholders, workers, and society by customer and investor behaviour, seen in share price (a firm's rising share price is not necessarily a sign of good corporate governance – it could actually be the opposite). "Bad" corporations were punished by selling. "Good" corporations were rewarded by buying. Market forces will sort it all out (invisible hand of...?). This ideology weakened the idea of CG and accountability. Can we rely on market forces (or numbers) only? (Capital availability and market liquidity without trust is threatened). Globalisation and e-technology are making reliable adjudications difficult. Why? Because boundaries of the firm in global economy have become diffuse through technology sharing and out-sourcing. Some corporations had a reputation for having the best risk management tools: a sophisticated mathematical modelling system. It was in reality a trap and they had biggest losses from mortgage derivates and CDO. CEO's reported that it was not a failure to appreciate complexity, but the opposite, a lack of simplicity and critical perspective. We were brainwashed by the superiority of mathematical modelling and there was little room in the risk management process for common sense questions such as: "How can assets that are as risk-free as cash earn so much more than cash? We must expect more conflicts of interest among risk managers and global auditors and credit rating agencies. Nowadays a core value and universal slogan is "Building a better world or better future". How to make that slogan sustainable?

A lot of people talk about corporate governance, but only a few of them talk about corporate governance failures – maybe because of speaking about failure or mistake (or bad intention) is not very pleasurable and can cause other problems for speaker or researcher. But failure in corporate governance is a real threat to the future of every corporation. Corporate governance as a business ethics issue is more powerful than the internet or globalisation and can destroy our business in a week. To make matters worse, standards of corporate governance are changing rapidly in response to random events which capture public imagination. In business ethics, what was good is becoming bad and what was considered bad is now good. Standards for corporate governance that have worked for decades look old-fashioned or immoral while other practices that raised questions are becoming totally acceptable. More complicated is talk about financial crisis and consequences of corporate governance failure (lost of trust and confidence, transaction costs). Crisis can pass off; distrust survives (financial crisis turned all short-term artificial gain "fictive profit" into losses, and governments must save "such profitable" great corporations and banks with taxpayers money). On the one hand, corporate governance in recent years have generated some excellent outcomes, but on the other hand, did not solve the fundamental problems, which are still in corporate governance practices (corporate governance system failed to prevent the recent financial crisis and corporate collapses because bad practices were not exceptions from the rules but widely used and often considered as "appropriate"or "good"). But debacles of historic dimensions (financial crisis, corporate governance failures) tend to produce an excess of explanations. Every commentator has a different

diagnosis and different prescriptions (very often are symptoms are exchanged for causation). We must not forget that the crisis is a result of mainstream economist's doing (not as a result of critique and prophecy from nonconformists).

"The financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements. When they were put to a test, CG routines did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies. The risk management systems have failed in many cases due to CG procedures rather than due to the inadequacy of computer models alone (risk models failed due to technical assumptions – one example David X Li Gaussian copula formula "The Formula That Killed Wall Street"), but the corporate governance dimension of the problem was how their information was used in the organisation: information about exposures in a number of cases did not reach the board and even senior levels of management, while risk management was often activity- rather than enterprise-based. These are board responsibilities. Last but not least, remuneration systems have in a number of cases not been closely related to the strategy and risk appetite of the company and its longer term interests. " ([3], p. 2)

This position of CGO adds to the company's public perception that it is a serious about doing business in a manner that surpasses mere compliance with legal and regulatory requirements. He can be in his role a planner (draw the corporate governance landscape for the company appropriate to the situation), educator (mandated to communicate and educate managers and co-employees on the why..., what... and how of CG) and implementer (ensuring himself with audit that corporate policies and processes are followed). Good governance is "a must" – a platform of best-practice governance principles, together with support from senior management and the Board of Directors is vital to attract shareholder confidence. CGOs must take theirs role seriously, and that is why they made integrity and quality the cornerstone of their businesses. Companies that fail to reform their governance will find themselves at a competitive disadvantage when they try to obtain capital to finance growth. High governance standards must be seen in practices and results of corporate activities. Good corporate governance is not simple and it is neither formality nor ceremony. An effective board of directors involves a combination of the right people, the right structure, and the right processes. To determine the appropriate combination for each individual company is the real challenge. Each company and country should consider its own circumstances before choosing the best way to improve corporate governance and to prevent corporate failures.

Corporate Values and Chief Executive Officer

If we ask a company leader the purpose of the organization's values, he will tell that they dictate a standard of workplace conduct that will bring benefit the company and the internal and external communities it serves. But in their essence, most organisational values relate to some simple but core behavioural principles: tell the truth, take complaints seriously, and follow problems through, treat customers and

employees fairly (even more – watch what you say and how you say it). So simple concepts, but somewhere along the way, enterprises seem to be getting off the track when it comes to integrating the values into the workplace culture. There are too many scandals and incidences of outrageous conduct to think otherwise. The wave of corporate scandals has been marked not only by the number of cases and amounts of money but also by the effect they have had on investor confidence and market values worldwide. But "Greed is Good, Ethics is better". But there are also some other interesting quotations (Goldman Sachs Chief, Lloyd Blankfein, on banking and the question on whether there should be limits to compensation said "we do God's work... This, in turn, allows people to have jobs that create more growth and more wealth. We have a social purpose" as he defends the bank's mega profits and bonuses. Mr. Blankfein made his comments just twelve months after bankers threw the world's economy to the brink of collapse). In a discussion about morality and markets at St. Paul's Cathedral in London, Goldman Sachs, international vice chairman and Brian Griffiths, a former adviser to Margaret Thatcher, described giant pay checks for bankers as an economic necessity: "We have to tolerate the inequality as a way to achieve greater prosperity and opportunity for all". John Varley, of Barclays, telling an audience at London's St. Martin-in-the-Fields that "profit is not satanic." [4]

Blankfein's wry comment that he is "doing god's work" seems almost to be a veiled jab at this sort of religion-public relations push, which to a serious banker of Blankfein's stature, must seem somewhat silly. Blankfein clearly knows who he works for. After all, God couldn't afford him. [5] - toto je citát, nie je v úvodzovkách

Laura Tyson (President Clinton's national economic adviser from 1993–1995 and former member of board of directors in Morgan Stanley) participated in 2009 at The World Economic Forum in Davos with Nouriel Roubini and Jacob Frenkel, Vice Chairman of AIG. Here are some interesting quotations from the panel:

... *"most individuals were doing the appropriate things"*

... *"as a member board I hadn't enough information"*

... *"political, financial, regulation culture went down"*

... *"it was collective failure"*

... *"we didn't understand the system"*

... Laura Tyson at panel: "*We teach the people to create new sophisticated instruments, they were done mathematically and basically an individual could believe they were creating a very unique risk management instrument, someone could purchase that for fee and feel they were managing their risks and then sell it to someone else. As a consequence of this we actually were building up risks in the system that no one was measuring.* " [6]

Ethics and Gatekeepers

It is human nature that we all want to live in a society that is fair and with rules. When we hear about a company or person who represents that company getting rich off insider trading (or self-trading) or costing taxpayers big amounts of money by

gaming the system – we can see that their actions led not only to their own demise but also the demise of their companies (to the destabilisation of society, debt trap). Greed leads to individuals and organizations crossing that line between healthy competitive capitalism and outright crime. CG and ethics play a vital role in sustaining the public's trust and maintaining investor confidence. What is now evident is that corporate governance is increasingly regarded as a management tool rather than a burden. CG has long been preoccupied with the balance of power between managers, boards of directors, and shareholders. Reforms that shift power from one party to another will not by themselves create more smoothly run, profitable organisations. We are not addressing the fundamental problems in corporate governance, which stem not from power imbalances but from failures in the corporate decision-making process. Doing business with integrity attracts and retains principled, motivated employees and also ethically-oriented investors. Institutional investors confirmed that in the wake of big firm collapses investment firms have become very sensitive to reputation risk. If even a hint of scandal is in the air, the firms sell "instantly" and ask questions later. Good governance (public/corporate) is central to operating in a society with increased environmental and social risks. Engaging the private sector in the achievement of sustainability is crucial. For businesses, and other institutions, an important part of this engagement should be based on sound governance (public/corporate).

In the recent global financial crisis corporate governance, internal policies, and leadership that guide the actions of corporations played a major part. Institutional investors exposed themselves and their clientele to extremely complex financial instruments (credit default swaps, investments in hedge, and private equity funds). This trend is characterised as a phenomenon "pursuit of alpha" culture that led managers to pursue risky financial strategies (The pressure is there for managers to produce interim and annual reports that demonstrate growth – but is this growth sustainable?). Institutional investors failed to effectively monitor such volatile investments, ignored relatively well-established CG principles. For too long time institutional investors have depended mostly on "gatekeepers" and the supposed checks and balances (e.g. credit rating agencies, banks as monitors, trading counterparties, self-preservation instincts of financial firms, reliance on the rationality of economic actors, efficient markets, investment chain of consultants, and money managers) to ensure if not create "sophistication". Few large institutional investors actively sought out minority views of financial risk, built alternative scenarios that would consider the possibility that the financial system might be significant fragile and crisis prone. There was little concern with asset inflation and leverage built up. In addition to having learned too little from the "bubbles" and subsequent collapses, the level of ability or willingness of sophisticated institutional investors to protect their own interests is very questionable. If "gatekeepers" are necessary but not sufficient, as is increased disclosure and transparency, then the only prudential recourse would be substantive investment and operations restrictions of various types and classes of investment (done properly, improved disclosure is an automatic by-product of good CG). The network of non-governmental gatekeepers (gatekeeper functions supplied

by outside professionals, such as attorneys and accountants, who assist the board and management in complying with law and with accurately reporting the corporation's financial position – for the benefit of investors and for the corporation's own understanding of its operations) and the supposed monitoring of investment and corporate governance risk by end asset owners failed (for a complex matrix of reasons – monitoring test was not sophisticated and incapable of monitoring adequately and effectively). It is necessary to reconsider the relation of CG to investment strategies and to risk analysis and monitoring.

Who are the gatekeepers? They are neither concierge nor doorkeeper staying at the door, but they have to stay on guard like a trustee, legal guardian. They are third-parties (intermediaries) whose cooperation is essential, who can prevent misconduct by withholding operation. They can provide information and certification for directors and investors. They have the ability to detect and deter misconduct and rely on effective CG. Recent corporate scandals before the crisis and during the period of economic crisis are demonstration of multiple gatekeeper failure. The failure of this network of gatekeepers was a recurring theme in the business scandals. In too many instances, the gatekeepers in pursuit of their own financial self-interest compromised the values and standards of their professions. In the recent round of corporate scandals, the first tier–the managers–failed, and then the gatekeepers failed as well. The gatekeeper role is currently unsettled and highly controversial. Reforms made gatekeepers stronger but many previous actions weakened incentives by reducing legal liability. Regulators should also sanction gatekeepers who fail to protect the shareholder. This would be a departure from the regulators' failure to bring a single action against any independent director of the companies involved in the recent major scandals. Regulators should closely examine every corporate fraud to determine whether gatekeepers have met their responsibilities to investors. A legal scholars say lawyers, accountants and financial analysts failed to "keep their bosses in check", which led to scandals (they failed to blow the whistle on their crooked corporate bosses – this is the root of the corporate frauds to the financial crisis). Corporate gatekeepers must stand up to executives. Investors relied on corporate gatekeepers who failed to give the warnings of expected financial debacles. Agency costs led to transfer of monitoring management by shareholders to gatekeepers. Because monitoring was in many cases completely delegated to these gatekeepers, failure by them was very costly to shareholders (the companies were operated without any real independent supervision). Gatekeepers failed to detect the corporate fraud where they had conflicting interests (auditors playing also a role of accountants), or where their distance from the company made detecting misconduct too difficult.

Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance (this should be corrected by the working of the external auditing process). But the question of gatekeeper regulation is problematic. Rules designed to minimise the extent to which gatekeepers can be placed in conflict situation are controversial and commendable. Safeguarding

gatekeeper independence can be very expensive. They are inevitably outsiders, and identifying irregularities is difficult and costly for them. Auditor may protect itself by conducting full forensic audits to ensure problems are spotted (this is costly and time consuming). The level of independence of corporate gatekeeper requires changes depending on the company. For some companies a suitable solution may be an internal audit committee and regular audits by an outside firm. Another company may require further supervision by solicitors or a regulatory agency (then it is complicated to identify the level of independence that is required). Also restricting the incentives available to gatekeepers can be detrimental to performance (it can motivate the auditor from establishing additional information flows with the company). Internal auditors adopt titles as investigators, gatekeepers, whistleblowers – as they fight the ongoing and very public battle against corporate fraud and malfeasance (but they are not the gatekeeper of corporate crime, nor are they responsible for the success or failure of the company's business operations and management) – because they cannot guarantee the accuracy of financial information obtained from the company's financial records. Internal auditor is in a better position than just about any other employee to discover fraudulent activity and report it to the appropriate internal or external authorities, but at what cost?

Institutional investors also played a "shining example" for other corporations to imitate their strategy. Institutional investors failed acting in their role of "gatekeepers" and promoting responsible investment. Institutional investors hugely misjudged the risk of CDS (financial weapons of mass destruction). Before financial crisis many corporations and institutional investors had incorporated environmental, social, and governance factors (ESG) into their investment and business practices. Although institutional investors monitored the behaviour of the companies in their portfolio, they did not apply corporate governance standards to the hedge funds and private equity firms they hired to select their investments. They relied on modern portfolio theory, but paid very little attention to the inadequacy of modern portfolio theory in managing systemic risk (widespread use of this theory magnified systemic risk). Also a barrier to shareholders' using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis[2], which suggests that the shareholder will free ride on the judgements of larger professional investors. Many systemically important financial institutions suffered failures of corporate governance and risk management. There were widespread failures by regulators and supervisors. Government's response was ill-prepared and inconsistent. The economic consequence of bank and corporate failure has been enormous. The social impact has been far-reaching. Policy makers have taken steps to try to strengthen the guidance on corporate governance and by introducing new rules. It is uncertain whether these measures will be effective in protecting company owners and members (there is always a possibility for side-stepping). The law of unintended consequences ensured that a well-intentioned

[2] In finance, the efficient market hypothesis (EHM) asserts that financial markets are efficient.

initiative has serious side effects (for example, limits for executive salaries at some level were side-stepped with remuneration packages that substituted the cash limit with stock options as the incentive for executives to fudge accounting performance to pump up stock prices). CG failures lead also to growing activity of shareholders – they believe that better corporate governance will bring those rewards. In the past they underestimated the need for monitoring the board practices and overrated financial performance when they evaluated companies for investment (in some cultures shareholders consider board practices to be more important than financial performance). It is evident, that it is very risky to prefer poorly governed corporations before well-governed (with a comparable financial performance). A well-governed company was defined as one that has a majority of outside directors with no management ties on its board; it undertakes formal evaluation of directors and is responsive to requests form investors for information's on governance issues. Investors are willing to pay more for shares of a well-governed company. Before the crisis in Europe and the USA, where accounting standards are higher, CG was less important. Failures CG came also as a result of non-effective continuous disclosure to shareholders of information on governance practices and financial issues. In some cultures there is a great need for more fundamental and better disclosure of information and for stronger shareholders rights (but they need to be more pro-active in their role as long-term owners). Compliance with corporate governance practices has a great importance in new conversation about what business is for, exploring how business impacts and shapes society and plays a crucial role in solving (or constituting) some of the world's most challenging issues (sustainability, unemployment, credit crunch). We can suggest that national growth requires "good governance", shared decision making and shared responsibilities. There cannot be any substitute for honesty in auditing and governance, consistent governance practices must be spread around the world, greater harmonisation in standards is needed. CG needs to be redesigned in the post-crisis world to add simultaneous value to customers, shareholders, employees, and society. In the current financial crisis is much frequented quotation of economists and politicians "*no one knows how much to whom owes",* and therefore without confidence no credit.

Corporate Governance and Development

The literature published after crisis has identified several channels through which corporate governance affects growth and development:

- An increased access to external financing by firms can lead, in turn, to large investment, higher growth, and greater employment creation.
- Lowering the cost of capital and associated higher firm valuation makes more investment attractive to investors, also leading to growth and more employment
- Better operational performance through better allocation of resources and better management creates wealth more generally.
- Good CG can be associated with a reduced risk of financial crises, which is

particularly important given that financial crises can have large economic and social costs.

– Good CG can mean generally better relationship with all stakeholders, which helps improve social and labour relationships, helps address such issues as environmental protection, and can help further reduce poverty and inequality.

Empirical evidence using various techniques has documented these relationships at the level of the country, the sector, and the individual firm and from investor perspectives". [6]

The failure of boards to intervene early enough to avert corporate disasters reflects a serious problem in the boardroom that cannot simply be swept under the carpet. The improvement in CG made so far after each crisis has failed to address a fundamental weakness: boards are often out of touch with those who can make (help) or break a company. Between the world inhabited by boards of directors and CEOs on the one hand, and the real world of customers, suppliers, and society at large is a great disconnect (that counts also for "world of financialisation and world of real economy"). Directors have a "duty of curiosity" to ask very awkward and sensitive questions and improve quality and flow of information within a corporation's governing structure and to the shareholders/stakeholders. In the world of CEOs and board directors made up of other CEOs and high rank executives who in a repetitive routine interact mainly only with one another, with management and sometimes with analysts, consultants and government officials. They have little if any ongoing regular contact with those who really know what is going on in enterprises. Economic disaster in great corporations reveal that board directors, especially of companies with widely dispersed ownership, often do not have enough specific industry expertise, neither contact with shareholders, nor other critical stakeholder groups, to support ambitious long-term value creation, or pick up the development of hidden risk before it is too late. There is a good idea of Warren Buffet to influence boards of directors to take a more active role in monitoring a company (requirements for the board of directors to align the director's interests with the shareholder): the director must be a long-time shareholder, the director must be a substantial shareholder, and he must only receive minimal compensation.

When some problems occur (hidden liabilities start accumulating in the form of "aggressive accounting" – ENRON, complex derivates based on mortgages to people who cannot pay, repeated equipment failures on drilling platform in the high seas, etc.) – these events are so far away from the world of boardroom that boards directors are often the last people to find out what is going on, and when they do, it may be too late. We must appreciate the distance between the boardroom and the real world, then the systemic failure of boards to promote value-creating growth and prevent corporate disaster comes as no surprise (one of corporate governance failures is this phenomenon). Boards have to go regularly beyond the analysts, consultants, and get into touch with the company's critical stakeholders (those that matter for creating long-term value, sensing the related risk). It is not enough to create regulatory barriers or to read more reports. It is not up to the board to assume a management role, but

listening to the value critical stakeholders to understand what is going on (then directors can make the right judgments and decisions in supporting, orchestrating (coordination) and supervising management. There are stakeholders whose input and resources are essential for the creation of economic value (shareholders, debt holders, trade creditors, suppliers, customers, and communities affected by the corporation activities). Internal stakeholders are the board of directors, executives, and other employees. When they are ignored, a firm's value creating potential is damaged, and lack of sufficient support from them constrains growth and long-term value creation. There is a growing body of evidence which suggests collaborative decision making vastly reduces the potential for business failure. The term "governed corporation" describes a new system of collaborative decision making, distinguishing it from the old "managed corporation", which stemmed from the dispersion of corporate ownership among many shareholders and the emergence of a new class of professional managers who were neither large shareholders or founders of companies (tougher management audits and external surveillance are no substitute for better decision making, which is needed). The long-term view is something of a rarity in many companies. A critical factor in many corporate failures was: poorly designed rewards package, including excessive use of share options which distorted executive behaviour towards the short term, the use of stock options or rewards linked to short-term share price performance, which led to aggressive earnings management to achieve target share prices. When we remove some best people, the firm would become an unimportant company. But there are in the firm also employees who can be easily replaced (they are not value-critical). Also individual shareholders in a widely held company are not value-critical, but large block shareholders are. Also influential organisations can be value-critical in the protection of consumers – they affect the reputation of consumer product companies. Enterprise risk analysis ought to look at how value creation could be threatened and identify the players who are important from the point of view "value critical" (internal and external stakeholders can be also critical for value creation). Boards must develop communication channels to the value critical stakeholders. There is a growing call following the financial crisis for more direct shareholder representation on the boards of the companies they own. The other stakeholders whose support is critical for value creation can be represented on the nominating committee to ensure that the board directors elected are in touch with the real world (value critical stakeholders could be also in special committees outside the board (risk, evaluation, new product, and brand). Boards need information about the web reputation of the corporate brand and not only use the whistle-blowing channels (for those on the frontline in business who know what is going on). Boards need a systematic light programme for each director to be in-touch with specific value-critical stakeholder. Many boards are briefed by top management talent (beyond regular contact with large shareholders). Board members meet not only with the chief risk officer but also one-on-one with their team members. Most corporate boards comply only with classical corporate governance standards (board size, independent directors, and committees). But how

many CEOs consider their boards to be as effective as their executive teams. Many chairmen consider it acceptable to have board members who do not add value – that is unacceptable on an executive team. Their view is that the board has to function only as a control mechanism on chief executives. There is an obsession with one side of the problem: the control of managerial misbehaviour. Boards can be a competitive advantage for companies. They can overcome blind spots in strategy of corporation, raise awareness of external risks, connected with governments, society and other stakeholders and give to the corporation behaviour and image more credibility and build trust in ways that executive teams cannot.

Risk Management and Coordination

"One of the important lessons of the recent crisis has been the failure of risk management in a number of companies. All too often, the focus appears to have been on internal controls for the purpose of financial reporting so that risk management became divorced from corporate strategy and its implementation. In a number of cases, the enterprise as a whole was not considered and boards were out of touch with the system in place. Risk managers were often separated from management and not regarded as an essential part of implementing the company's strategy. Effective risk management is not about eliminating risk taking but the aim is to ensure that risks are understood, managed and, when appropriate, communicated. Risk management is typically not covered, or insufficiently covered, by existing corporate governance standards or codes. What is needed now is to bring together and to reinforce the need for internal controls with the need for assurance to the board about risk management and therefore the implementations of its strategic objectives (direct reporting of financial controls, direct reporting about risk positions to the board to avoid the conflicts of interests of line management). It is considered good practice that risk management and control functions are independent of profit centres and the "chief risk officer" or equivalent should be able to report directly to the Board". ([3], pp. 13-15)

Boards need more than all this to become truly effective. Their strategic role is different to the strategic role of executives (supervision ensuring the company's strategy is right and well implemented, co-creation with overcoming blinds spots, supporting the executives within the company and with outside stakeholders). Very often there is also a very weak coordination. Boards have not only to monitor the company's innovation performance but actively contribute to it. The board is now essential to corporate success. Employee representatives can also be an excellent source of innovative thinking. Today's chief executives are over-stretched and confronted with an incredible rise in complexity from society, governments, alternative business model, global changes, new risks and opportunities, and a great shifts in economic conditions. Even the very best executives cannot be automatically expected to respond consistently to all these challenges. Now it is the time to go beyond governance rules towards true practices and behaviours that will reinforce

the trust of all into the future success of the companies. Citizens wish to share economic successes in their countries; they demand improvements in quality of their life and to see better fairness, transparency, and job opportunities. (Good CG cannot exist without an efficient level of public governance). This interdependency between the public and CG can lead to better corporate performance and international competitiveness (improving practices and behaviours) and also attract more foreign direct investments. It is no longer about producing thick governance manuals or filling up tests. It is also about effectively, transparently managing business for performance with the cultural values of the country and the carrying out effective management for all parts of society. Improvements in performance and competitiveness depend not only on buying (mergers, acquisitions, and takeover) but also in managing. CG in some countries is driven usually by the need for more foreign investment and fast development of financial markets and related problems (credit crunch, debt crisis).

The recent financial crisis has had a devastating impact around the globe (businesses have closed; jobs have been cut; many people lost their homes). The current crisis and the Asian financial crisis of 1997 have one common cause – failure of CG (CG reforms after the 1997 Asian crisis has helped dilute the effects of current crisis in Asia). What we face now is a crisis of liquidity and not insolvency. But it is not enough to introduce new rules and regulations, without much attention being paid to its enforcement. Key economies have fallen now into a debt trap, linking the financial sphere to the real economy, and looks into alternatives to the constant stream of financial bubbles and shocks. It is very interesting (but overlooked by many) that cooperatives across the world have been relatively resilient throughout the crisis (better strategies, cooperation, management, control, and good governance) because of direct influence of non-anonymous owners of enterprise (compared with anonymous or small owners acting as shareholders in corporations). Financial crisis also showed that human emotion has a critical impact on financial markets and corporate environment. Current economic theories have failed to take this into account (but there are some exceptions as "emotional finance" or "neuromarketing, event marketing"). At the heart of the worst financial crisis was a failure to organise markets in a way that adequately controls the very human emotion and behaviour which trading unleashes. All this is occurring at a time when global governance is in parlous and paralysed state (narrow focus on markets at the expense of other factors). Business has been, at best, myopic. The real world (economic) cannot be separated into functional (dysfunctional) departments. Nowadays all problems in our world (geopolitics, social forces, climate change, trade policy, and markets) are inter-linked. We live in a highly interconnected world, but also a very fragile and volatile one. Business needs to understand – not only the dynamics and strategic implications of integration across markets, but also the strategic implications of the integrative dynamics across technology, resources, society, and politics. Business should be a force for greater global responsibility (through the promotion of robust and effective global governance) and corporate responsibility. As for corporate governance principles, it is widely accepted that they will be converging around the

world. But there is a dichotomy between the "Anglo-American" shareholder corporate model and the European stakeholder model. In European region there are two basic models of corporate governance (Anglo-American and continental European models). The two models are differentiated by important factors (Table 1).

Table 1

Models of corporate governance

Anglo-American model	European model
- management dominated	- controlling shareholder dominated
- shareholder focused	- stakeholder focused
- wide public share ownership	- narrower public share ownership
- strong shareholder rights	- weaker shareholder rights
- unitary board structure	- two-level board structure
- single powerful leader	- consensus or divider leadership
- shareholder litigation culture	- weaker litigation structure

Source: ([10], p. 5)

Models are merely intellectual constructs. They do not capture reality in all its complexity (ethics, law, management, and culture). Elements indicated above represent issues that differentiate and influence the various approaches to corporate governance within the Europe region. Significant and powerful forces, such as the need to access foreign capital markets, the pressure of institutional investors, and the drive to create a single European market in financial services may tend to foster a certain convergence among corporate governance systems in the region. But CG systems are not simply forms that can be replaced without problems. Systems of CG like many other society's institutions, contain its cultural values which are essential for social survival. For example, one cannot assume that American values of individualism will easily replace European attachment to community values.

A decade ago it was widely thought that these practices around the world would gradually converge into the United States model. But that was before the collapse of great corporations and the ongoing global economic crisis. It was also believed that the world needs access to American capital, and therefore it is necessary to converge with US practices. That is not longer the case and convergence or differentiation question remains unsolved. CG codes of good practice in many countries have a striking similarity, and they influence each other (they emphasise corporate transparency, accountability, reporting, and independence of governing body from management). Now also strategic risk assessment and corporate social responsibility are included into consideration (responsible investment, environmental – social and corporate governance, socially responsible investing, etc.). The codes published by international bodies (World Bank, OECD, etc.) and corporate governance policies and

practices of major corporations operating around the world encourage convergence, too. International accounting standards and securities regulation are certainly converging. Global concentration of audit for major companies in just four firms encourages convergence, too. Major corporations all over the world want to have the name of one of the four principal firms on their audit reports (they are locked into a firm's world-wide audit, risk analysis, and other governance practices). But there are also tendencies to establishing new audit companies in the European Union or China in order to have more competition building up competition and support independent auditing and rating. But great international institutional investors explicitly demand various CG practices if they are to invest in a specific country or company. Legal differences in company law, contract law, and bankruptcy law between jurisdictions affects CG practices (codified law of Continental Europe – controlling shareholder dominated model, case law in the US, UK, etc – manager-dominated model). Corporate concept is now rooted in law, and the legitimacy of the corporate entity rests on regulation and litigation. The Western world has created the most expensive and litigious corporate regulatory regime. In Asia and other countries exists reliance on relationship and trust in governing the enterprise, and this may be closer to the original concept of corporate governance. Also consequences of financial and economic crisis are not so extreme in these countries. Therefore global convergence of corporate governance systems at any greater depth would need a convergence of cultures, and that seems a long way away. Maybe we are searching for new "Gold Standard" for corporate governance – how to devise systems, rules and institutions that will induce corporate executives to manage corporate assets in the interests of the shareholder, rather than their own. The dispersion of share ownership in the US served to render shareholder powerless. In Europe is share ownership much less dispersed among the public than it is in the US, and therefore central preoccupation of corporate governance should not be the right of shareholders in relation to managers, but rather the rights of community in relation to the corporation itself – corporate social responsibility (employment, salaries, and environment).

"The Steering Group considered that there are four areas of corporate governance closely linked to recent failures: remuneration/incentive systems, risk management practices, the performance of boards, and the exercise of shareholder rights. Areas are closely related: if remuneration has been excessive and/or not structured properly, why have the boards allowed this state of affairs to occur? If risk management has failed to manage risk oriented remuneration systems, why have the boards apparently stood back or are we expecting simply too much of boards in large complex companies which are to a great extent themselves a product of board and shareholder decisions? Why have shareholders not been able to ensure accountability? It also covers the issue of implementation of existing corporate governance standards." ([7], p. 13)

Economic crisis was not a pleasure social event, but a disaster caused also by CG failures. In many researches we can find causal agents of failures. But hardly anybody saw symptoms of threats of frequent misbehaviour against ethics and ethical values, CG rules and practices. Maybe it was only malfunction of perceptiveness of many

skilled professionals. It could be happen by happenstance – coincidentally. But simultaneously? Too many accidents escalated in economic disaster. It was then widely accepted that it was a systemic failure. But who was guilty? System (CG practices, regulatory practices) permitted to make mistakes and improper, immoral behaviour. This process was not short but lasted a long period and big losses were "invisible" for many corporations. Risk evaluation practices and risk calculations with magic formula created in global economics and in the atmosphere of harmony and consonance which was transformed to dissonance. The faith that all will be O.K. cannot repair damages – after a deep analysis real deeds are needed.

View of Insider about Corporate Governance

Greg Smith's[3] open letter "Why I Am Leaving Goldman Sachs" published on March 14, 2012 in The New York Times is a good example of real effort of corporations to improve corporate governance practices just for appearance's sake or not to lose the face. He wrote: "*Today is my last day at Goldman Sachs. After almost 12 years at the firm – first as a summer intern while at Stanford, then in New York for 10 years, and now in London – I believe I have worked here long enough to understand the trajectory of its culture, its people and its identity. And I can honestly say that the environment now is as toxic and destructive as I have ever seen it."* This open letter has created a stir in the investment banking industry and also showed real corporate governance practices. It has also raised some fascinating questions about the company – and finance capitalisms in general. Greg Smith complains of *"sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them"* and harks back to the days when the success of Goldman's clients was at the forefront of its executives minds. He said: *"It makes me ill how callously people talk about ripping their clients off"*. But has this investment bank ever been a benign force in the business world or has maximising profit always been its overriding motivation? Doesn't the health of a business, according to the dogmas of 21st-century capitalism, rest on its ability to squeeze the most out of its customers? It is evident, that in many cases the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. Greg Smith continued in his letter: "*The firm has veered so far from the place I joined right out of college that I can no longer in good conscience say that I identify with what it stands for. The corporate culture was the secret sauce that made this place great and allowed us to earn our clients trust for 143 years. It wasn't just about making money; this alone will not sustain a firm for so long. It had something to do with pride and belief in the organization. I am sad to say that I look around today and see virtually no trace of the culture that made me love working for this firm for many years. I no longer have the pride, or the belief. I truly believe that this decline in the firm's moral fibre represents the single most serious*

[3] Goldman Sachs executive director and head of the firm's United States equity derivatives business in Europe, The Middle East and Africa.

threat to its long-run survival. Today, if you make enough money for the firm (and are not currently an axe murderer) you will be promoted into a position of influence. It astounds me how little senior management gets a basic truth: If clients don't trust you they will eventually stop doing business with you. It doesn't matter how smart you are. I hope this can be a wake-up call to the board of directors. Make the client the focal point of your business again. Without clients you will not make money. In fact, you will not exist." [8]

This open letter was no scientific research but rather empirical and experimental economist work of high rank executive officer. A lot of researches about corporate governance failures are embellishing and ignoring that all this disaster was caused with permanent (even perpetual?) wrong doing. Greg Smith's letter could be considered as funeral oration or epitaph. It is not enough to make some formal changes in corporate governance codes but try to motivate board of directors and executive officers to be consistent (and have integrity) in exercising good corporate governance (and responsible investment) principles. Everybody can make mistakes, but it is very dangerous to repeat mistakes of the others (following the herd, imitating the competition and something that seems to be success that is in reality only defeat on the end). Defeat for customers means also defeat for corporation. [8]

Conclusion

Corporate governance failures influenced outbreak of the crisis, and now CG has an important role to play in overcoming the financial crisis, restoring confidence for the future and preventing regulatory overkill that would damage the entrepreneurialism needed to secure future economic growth. CG reforms are driven by the increasing need for extra-secure sources of capital in a period of globalisation. Improved CG standards may attract investors disappointed by downturn in the US and European markets. Corporate governance issues (they are extremely important and should be a priority) are complex and remain controversial, there will be obstacles to resolving them, particularly in the midst of the financial crisis. Using corporate governance can create a competitive advantage for companies in the business environment. Global authorities should continue to work with market participants to develop enhanced governance practices that will underpin other regulatory actions being taken to address the current problems. Corporate governance have to promote honesty, integrity, transparency, fairness, accountability, and proper relationships with other companies in the business environment because it plays an important role in restoring investor trust.

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