THE BOARD eMANUAL
on
CORPORATE GOVERNANCE

Volume 1:
The ACG Methodology: A New Approach to corporate governance

Nigel Kendall and Arthur Kendall

www.applied-corporate-governance.com

The Board eManual on Corporate Governance

Understanding and Implementing corporate governance

Objectives of this corporate governance course are to:

- define Applied Corporate Governance and the holistic approach
- instruct existing and future board members in how to establish a system of good corporate governance:
  - strategic management process
  - agreeing goals
  - strategic plans
  - monitoring role
  - reporting back to stakeholders
- equip you with the skills and tools to build an open, ethical organisation in touch with the needs of all its stakeholders

The course, and the methodology described in it, is designed to give you education and training in commercial board best practice and requirements. Highly results-oriented, our methodology is based on a holistic approach to corporate governance which places the issue at the heart of good management and takes into account all the Company's stakeholders. It draws on the training programme carried out with a large client and our book Real World Corporate Governance, originally published by FT Pitman and brought up to date in the Applied Corporate Governance website by subsequent experience.

We have arranged the course as an "eManual", a series of ebooks in convenient PDF format for universal accessibility. It is designed to provide practical help in implementing good corporate governance.

Learn the essentials of good governance with
*our **5 Golden Rules of Corporate Governance!***

Throughout the series, we define the fundamentals of good corporate governance and explain how to check how your organisation performs against these rules. Adhering to these rules will ensure a healthy, sustainable business or not-for-profit/non-governmental organisation† and make compliance with the various international governance codes naturally easier.

For more information on our training and consultancy services please contact us at info@applied-corporate-governance.com*.

*Please note: the first time you email us you will receive a mail delivery warning asking you to add your address to our whitelist; this avoids us receiving spam to this address which can be easily guessed by spammers.

Applied Corporate Governance is a trading name of Tangley International Ltd. Registered in the UK.

† *Note: while this eManual was originally designed for commercial organisations, the principles apply equally to not-for-profits and non-governmental organisations (NGOs). This is because of the holistic nature of the methodology and view that all organisations, commercial or otherwise, should be guided by the same principles. If you are a non-commercial organisation, contact us for **special terms**.*

Preface: The Role of the Board

What distinguishes direction from management is that there has to be a strategic awareness combined with lateral thinking and the power of delegation. The directors, and no-one else, have the ultimate responsibility for the Company to its stakeholders. Their role is to:

- define the Company's business and long-term objectives and identify strategic opportunities
- make sure the Company has access to the right quality of people, technology and organisation
- set the cultural and moral tone of the Company
- evaluate and monitor the chairman and the chief executive and if necessary replace them
- evaluate the internal controls to ensure the protection of the stakeholders and to evaluate the financial statements issued by the Company
- take care that the Company has effective management processes for making sure that its resources are applied to the profitable exploitation of business opportunities
- oversee the process of management development to provide an adequate succession

There are two critical factors in carrying out these roles. The first is a creative and stimulating chairman who carries weight and respect throughout the Company, not just at board level. His or her role is key – to build a team and to weld it together. To do that, the chairman also needs a second factor, namely the vision and independent perspective of directors who are not part of the operating management of the business.

Contents

What is Corporate Governance?

In the UK and US the debate over the past few decades has focused on the separation of ownership and control and consequently the relationship between shareholders and management. The New Approach puts the issue in the wider context of responsibility towards all parties with an interest in the business. This defines corporate governance as:

A system of structuring, operating and controlling an organisation to achieve the following:

- *a culture based on a foundation of sound business ethics*
- *fulfilling the long-term strategic goal of the owners while taking into account the expectations of all the key stakeholders, and in particular:*
    - *consider and care for the interests of employees, past, present and future*
    - *work to maintain excellent relations with both customers and suppliers*
    - *take account of the needs of the environment and the local community*
- *maintaining proper compliance with all the applicable legal and regulatory requirements under which the company is carrying out its activities*

This definition (as published on www.applied-corporate-governance.com) has to be taken in the context not of a separate discipline, but of improving the management and the health of the business using – but adapting – *existing systems*, which is the rationale behind the New Approach.

Corporate Cultures and Vision

The importance of vision in any business is clear. Without vision a strategy will have no drive or obvious direction. A corporate culture which is based on an open, ethical view of carrying out the business must eventually win over secretive, unscrupulous cultures.

Many examples exist of successes of companies with such an open culture and of failures of those without. Below are a few:

Quote:
"When Bill Hewlett and I put together the initial plans for our business enterprise in 1937 ... (we decided) that we wanted to direct our efforts towards making important technical contributions to the advancement of science, industry and human welfare."

David Packard, The HP Way, Harper Business books 1995

This quote from David Packard, at that time Chairman Emeritus of Hewlett-Packard Society, expresses the early aspirations of two entrepreneurs when they started their business. These principles became, for a time, immortalised as a method of doing business – "The HP Way", and HP grew into a globally successful business. In recent years the tribulations of HP as it has struggled with intense competition in its industry and has chopped and changed its strategy as it chopped and changed chief executives, perhaps points up the dangers of losing confidence in a strategy and then losing sight of a clear goal.

Quote:
"The supreme purpose of the John Lewis Partnership is simply the happiness of its members"

John Speedon Lewis

Of course the success of the John Lewis Partnership over the years since 1929, when Lewis put the family assets into a trust for the benefit of past, current and future employees, was not simply down to the aspirations of a benevolent founder. Its customer focus with its famous motto “Never Knowingly Undersold” has been at the core of its success, but the unique partnership style, with the loyalty and commitment it has fostered, has undoubtedly helped it stay at the forefront in that most competitive of markets, consumer retail.

This ability to create a vision and turn it into a way of life for a company may be regarded as nothing unusual until one compares a supposed entrepreneur and builder of multinational corporations, Robert Maxwell, whose empire collapsed after he died, with another entrepreneur, Thomas J Watson, whose creation, International Business Machines, is still a global force to be reckoned with nearly 100 years after he founded it. More recent examples of the almost blind pursuit of financial targets at the expense of traditional culture and vision are Royal Bank of Scotland and Lloyds TSB. Fred Goodwin was led by the excessively ambitious acquisition of ABN Amro to “bet the farm” and virtually destroy RBS, one of the oldest pillars of the banking world, and at Lloyds TSB Bank, Victor Blank as chairman was encouraged by the then UK Chancellor of the Exchequer Gordon Brown to rescue HBOS with a minimum of due diligence and the promise of a dominant market position with a regulatory blind eye, resulting in the near destruction of Lloyds.

An example on the positive side was the turn-round achieved by Steve Jobs, the formerly ousted co-founder of Apple after his return in 1997 to a near bankrupt company. Over the next 15 years his single minded vision turned it in to a market leader and by 2012 the most valuable company in the world. No muddled vision or chopping and changing strategy here.

Principles of good corporate governance

From the above examples we can draw some conclusions and formulate a short set of rules regarding the practice of good corporate governance. Applied to corporations we see that successful ones have to a great degree abided by these rules and failed ones have to a large extent ignored them. The principles underlying these rules are:

1. ethical approach – culture, society: organisational paradigm
2. balanced objectives – congruence of goals of all interested parties
3. each party plays his part – roles of key players: owners/directors/staff
4. a decision-making process in place based on a model reflecting the above, giving due weight to all stakeholders
5. stakeholders treated with equal concern – albeit some have greater weight than others
6. accountability and transparency – to all stakeholders

With this in mind, running the business successfully cannot be simply about market domination or shareholder value. And good corporate governance is not simply about the relationship between directors and owners, but about the ethos of an organisation and fulfilling its clearly agreed goals.

To arrive at universally acceptable goals, there has to be a process of identifying the different needs of stakeholders, and, as much as possible, harmonising them. This is the starting point for the smooth running of the business – keeping all parties in tune with the goals of the business and thus with each other.

Five Golden Rules

The approach set out in this manual is based on two fundamental concepts:

- the business morality or ethic must permeate the entire operation from top to bottom and embrace all stakeholders
- good corporate governance is an integral part of good management practice also permeating the entire operation, not a separate issue addressed by auditors etc.

the principles of this approach are framed in relation to the conventional way of looking at how a business should be properly run.

Five Golden Rules:

1 Ethics: a clearly ethical basis to the business
2 Congruence of goals: appropriate goals, arrived at through the creation of a suitable stakeholder decision making model
3 Strategic management: an effective strategy process which incorporates stakeholder value
4 Organisation: an organisation suitably structured to effect good corporate governance
5 Reporting: reporting systems structured to provide transparency and accountability

This approach recognises that the interests of different stakeholders carry different weight, but also that all stakeholders should be treated with equal concern and respect. Like the spirit of the US constitution, the approach can be said to embrace liberty, equality and community, but like the US economy, it aspires to produce the most powerful and effective result in the world.

Good corporate governance is good management

The essence of success in business is:

- having a clear and achievable goal
- having a feasible strategy to achieve it
- creating an organisation to deliver
- having in place a reporting system to guide progress

This is clearly what is described as good management. Good governance is about achieving the stakeholders' goal, and delivering success in an ethical way. Hence it follows that it must entail a holistic application of good management.

To demonstrate the totality and the need for a holistic approach, fig 1 on the following page shows the pressures on a large organisation.

It is important that a wide perspective is taken when considering corporate governance because it cannot be emphasised too strongly that good management practices will deliver good corporate governance. Compliance with checklists of regulations and codes, in the setting of bad management or a lack of commitment to good management will **NOT** deliver good corporate governance. The longer term consequences of this externally-applied regulatory approach will be a progressive introduction of more and more rules which are held in less and less regard, and which produce less and less effect.

This may spawn a small industry of specialist advisers in corporate governance and lobby groups (which has already started to happen), but the result will benefit neither business nor its customers.

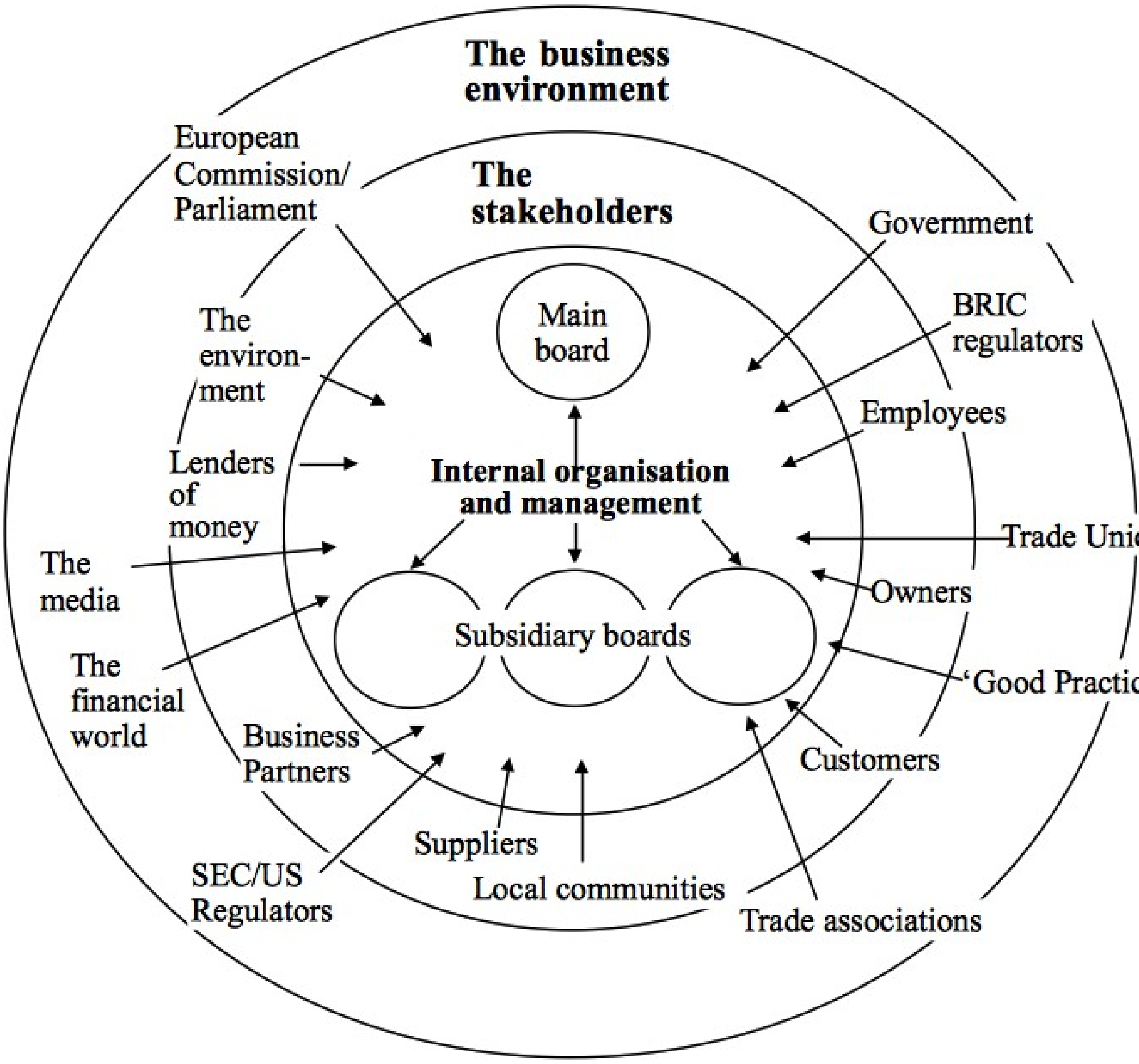

Figure 1: Pressures on an organisation

Corporate governance and the strategic management process

Without a clear goal, management faces an impossible task in trying to do its job properly – what exactly is its job? A general rule should therefore be observed: the governance, the goals and the strategy of the business must be compatible, and there must be congruence between the expectations of the various interested parties. Clearly this means that:

- there is a common view as to the ethic by which the business is conducted
- the views of all interested parties are taken into account when deciding the goal
- an appropriate weighting is given to those views to arrive at a conclusion as to how to achieve the greatest good
- a strategy is formulated to attain the chosen goal which takes account of the likely behaviour of the various interest groups
- an implementation programme is drawn up which makes the necessary organisational

arrangements to fulfil the strategy and to protect the interests of the various stakeholders
- the implementation programme includes reporting systems which ensure transparency and regular feedback on maters which affect them to the various stakeholders

This and the other ebooks in this Board eManual series are devoted to the process whereby the board, and the company's main stakeholders, can ensure that the company complies with the Five Golden Rules of good corporate governance.

Having established that good governance is all about good management, we present the totality of a strategic management model so that the elements which are more specific to this subject are placed in context. The approach draws on Michael Porter, whose ideas are now widely accepted and adopted. The overall process is summarised in figure 2:

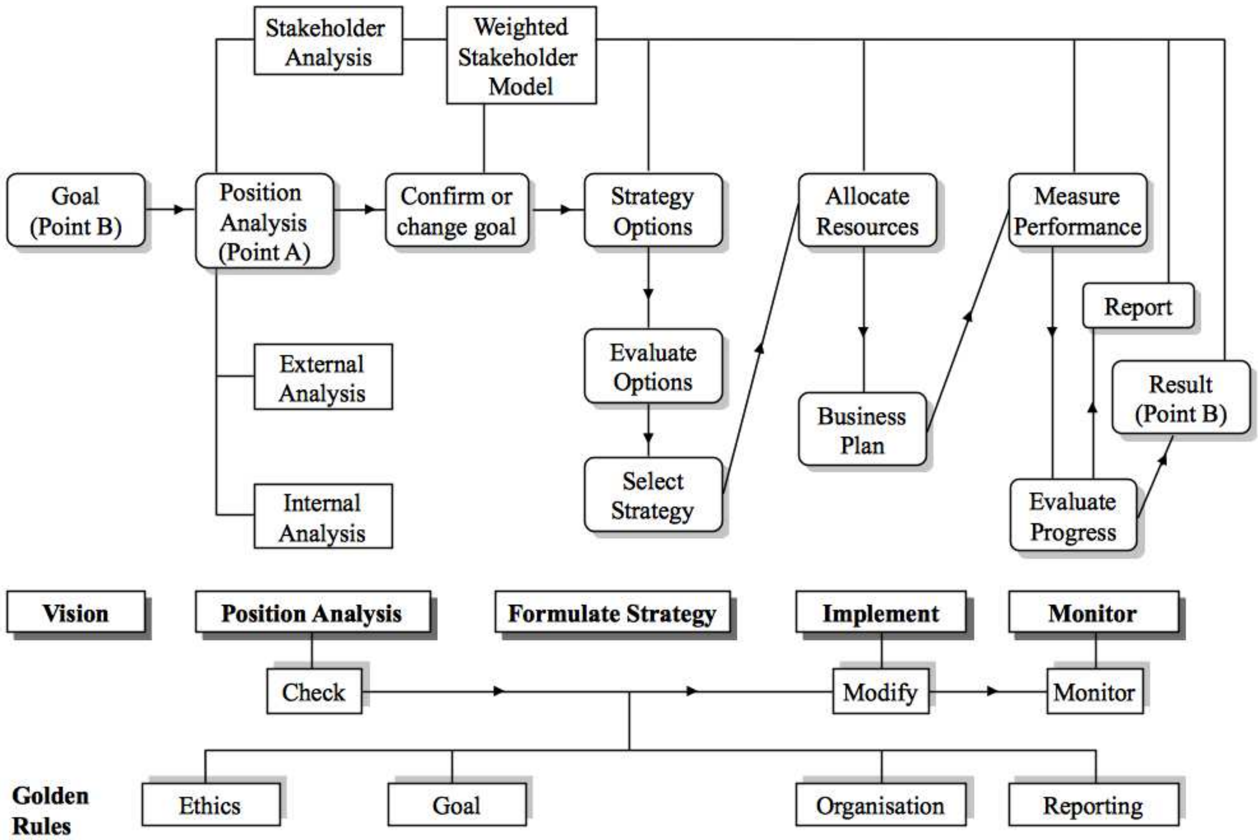

Figure 2: Corporate governance and the strategic management process

To the Position Analysis, which ordinarily consists of internal and external analyses, we have added a Stakeholder Analysis, which starts at the beginning by ensuring we know who all the stakeholders actually are, and by finding out their feelings and expectations of the company.

The whole picture

The key to the approach and the methodology designed to achieve good corporate governance, lies in building the concepts set out herein into every part of the business. Figure 3, below, puts this into context by showing that everything starts and finishes with the strategy process. It is the vehicle for starting the whole process and the destination for all the results obtained from the analyses, and it is also the vehicle for applying corresponding changes in policy and organisation. We cover in detail how the strategy should be carried out to incorporate stakeholder involvement in our **Strategic Management and Corporate Governance ebook**, but from an overall perspective, the model below demonstrates how the Golden Rules approach relates to the whole business.

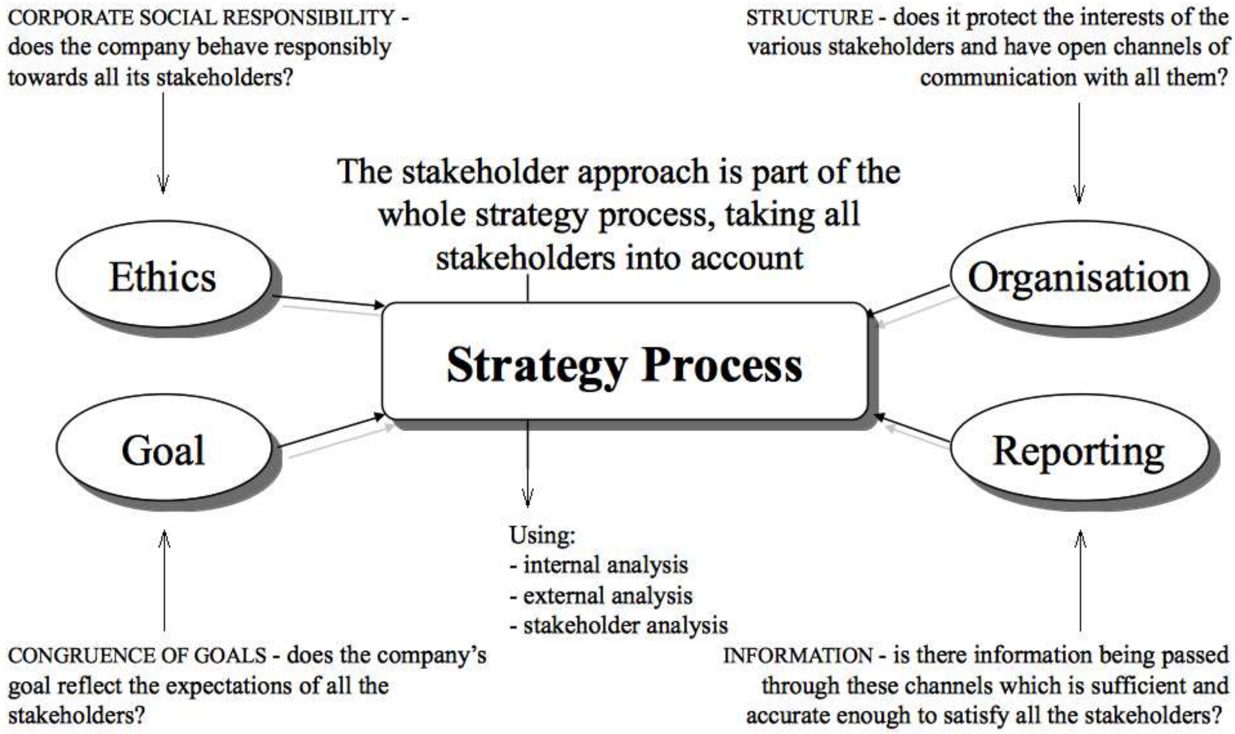

Figure 3: The stakeholder approach and the strategy process

The methodology – a summary

1. Using the internal, external and stakeholder analyses, a balanced view can be found of:
   - **Ethics:** what the board thinks of the company's ethical behaviour may not be the same as what other stakeholders think – the differences may simply be due to lack of communication (which will show up later) but need to be reconciled.
   - **Goal:** the crucial part of the process – if the company's "agreed" goal is found to be significantly different from what stakeholders want, the goal will have to be adapted or changed completely.
   - **Organisation:** the company must ensure that it has an organisation capable of delivering good corporate governance – from the stakeholders' point of view, this means ensuring accountability through direct contact with all stakeholders, whose views may be unclear or even unknown.
   - **Reporting:** how much do the stakeholders actually know about the business? Finding out and comparing this with what they should, or what the board think they know, will provide further strategic guidance.

2. The information gathered is then fed *back into* the strategy model and used to make any changes necessary to:
   - **the ethical stance** or the resources made available to improve the company's image, for example
   - **the goal** – the general direction in which the company is moving
   - **the organisation** – this process automatically opens up communication channels if they were lacking before, but these will need to be rationalised; it will also have exposed any structural or operational inefficiencies, etc., which are affecting particular stakeholders
   - **reporting systems** - having opened up these channels, it is then possible to monitor progress and ensure stakeholders are getting all the information they need and this function, too, will have to be rationalised

3. After a strategy has been selected and implemented, the steps taken above will enable continuous evaluation of progress of the strategy and the effect it is having on stakeholder attitudes to the concepts addressed by the Golden Rules – particularly usefully, ethics and the goal. As figure 2 shows we will need to monitor all four elements – including the organisation and the reporting systems themselves – to ensure continuing high standards and that we are receiving accurate, timely information to feed back into the model.

Note: *ebook 4 in the series, "Corporate Governance and Strategic Management" describes how the strategy process is used to conduct a corporate governance "audit": the sections around it therefore describe aspects and factors of governance which must be applied when conducting the audit and the processes therein.*

Conclusion: profit-enhancing stewardship

To borrow from the sub-title of our earlier book, corporate governance should make a real difference to the bottom line (or in the case of non-profits and NGOs, the funds available and the effectiveness of their use). If not, it is just warm, fuzzy but meaningless words which do not genuinely contribute to sustainable development and will never succeed against the naturally self-serving nature of so much of modern society.

The approach and methodology outlined in this ebook, and explained in more detail in the other ebooks in our CG eManual series, is designed to open a genuine dialogue with all stakeholders to ensure we really are acting in the best interests of everybody and therefore to increase our chances of success. Ultimately, this may result in an easing of some of the more dramatic, stratospheric profits some corporations register, but it should also vastly reduce the risk of corporate failure and build sustainable financial strength through trust, accountability and transparency.

Building long-term relationships with stakeholders is the only viable way of doing this and is the only way we see to build a new world in the wake of the financial crisis and to ensure that emerging economies sustain their progress and even provide a better example (than “developed” nations) of how to lift – and maintain – the living standards of their peoples.

Other ebooks in this eManual series

- Ethics in business: defining and measuring ethical performance
- Towards a common goal: goal-setting and stakeholder buy-in
- Strategic management and corporate governance: the whole picture
- Organising to deliver corporate governance: culture, accountability and leadership
- Accountability means YOU: building a communication system for reporting and transparency