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A CORPORATE GOVERNANCE MODEL: BUILDING RESPONSIBLE BOARDS AND SUSTAINABLE BUSINESSES

Foreword

The foundation of good corporate governance is the intellectual honesty of directors and senior management. This intellectual honesty is expressed by acting in the best interests of the incapacitated company. The company, on formation, is a person, but it is absolutely incapacitated until its directors are appointed and the board in turn delegates to management the implementation of its collective decisions.

It is the quality of governance that is important and not the quantity. Mindless compliance with a set of rules is not good governance. Good governance connotes acting with responsibility, accountability, fairness and transparency. Transparency has a withering effect on misconduct and is absolutely critical in communicating to stakeholders any decisions of the board. In this context, transparency demands that the communications consist of substance over form and contain positive and negative aspects, if any.

It is correct, as mentioned by Dr Argüden, that a company needs the right people, team and processes. The right team making up the board must determine a common understanding of the purpose of the company, the values that drive its business and who are the important stakeholders. The board must also identify the sustainability issues which are pertinent to the business of the company.

The board needs to adopt the inclusive approach to governance. This means that the board, in its decision-making process, needs to take account of the legitimate interests and expectations of the stakeholders linked to the company. Management must communicate with the particular groupings of stakeholders.

Now that sustainability has become the moral and economic imperative of the 21st century, governance, strategy and sustainability have become inseparable. Long-term strategy must follow consideration by the board of five capital aspects, viz. financial, human, social, environmental and manufactured/technology. Reports to stakeholders must integrate the impacts of the company's business on a community, economically, socially and environmentally.

International Finance Corporation
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Whilst it is the duty of directors to take risk for reward, directors must ensure that they apply the principles of good governance when taking risks for reward. Good governance attracts capital, whilst poor governance will repel capital. Capital has become a scarce resource in a flat, borderless world, where, with the click of a mouse, capital can leave a market and destroy it. *A Corporate Governance Model* by Dr Argüden gives one an understanding of good governance principles and practices.

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A CORPORATE GOVERNANCE MODEL: BUILDING RESPONSIBLE BOARDS AND SUSTAINABLE BUSINESSES

Dr. Yılmaz Argüden[1]

Trust is the foundation of sustainable development. As the world continues to get smaller, our mutual interdependence increases and we all need to be able to mobilize others' resources and goodwill to achieve success. Mobilizing others' resources can only be achieved through gaining their trust.

Therefore, the ability to gain the trust of global financial markets and all the stakeholders in the value chain is becoming the key to success. This requires consistent, responsible, accountable, fair, transparent, and effective organizational structure, decision processes, and people. The quality of the governance of a firm is as dependent on the organizational structure and decision making processes of the firm, as to the quality of the key people that make up the board and the management team.

Being trustworthy is an important asset and source of power for corporations as well as it is for individuals. Gaining trust takes a long time, but its loss could happen in a very short period. In order to gain trust, the consistency between the words and deeds is a requirement because behaviors show the priorities and preferences in a more effective manner than words.

During the last decade significant number of corporate failures increased the impetus for governance regulations both voluntary and mandatory. However, the tendency to follow such a compliance oriented approach has the potential to bring significant overhead without sufficient improvements in quality of governance.

Corporate governance refers to the quality, transparency, and dependability of the relationships between the shareholders, board of directors, management, and employees that define the authority and responsibility of each in delivering sustainable value to all the stakeholders. In order to attract financial and human capital to the corporation and to ensure sustainability of value creation, the governance mechanisms should ensure to gain the trust of all stakeholders.

The essence of good corporate governance is ensuring trustworthy relations between the corporation and its stakeholders. Therefore, good governance is a lot more

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than compliance. Good corporate governance is a culture and a climate of **C**onsistency, **R**esponsibility, **A**ccountability, **F**airness, **T**ransparency, and **E**ffectiveness that is **D**eployed throughout the organization. (The "CRAFTED" principles of governance).

Good governance is a lot more than compliance. It is a culture and a climate of consistency, responsibility, accountability, fairness, transparency, and effectiveness that is deployed throughout the organization.

The board of directors is the most important element in corporate structures. Issues such as the composition of the board of directors, the issues that the board focuses on, processes they follow for decision making and how they **L**earn to continuously improve the governance of the corporation critically influence the quality of decisions and the management quality. The main responsibilities of the board are to provide an effective **O**versight for the management and **G**uidance to the corporation with value creating strategies. The quality of their decisions is critically dependent on the quality of the **I**nformation they have. Establishing a **C**ulture that sets the right tone at the top is critical for establishing the 'trust' for the corporation.

"CRAFTED" Principles of Corporate Governance

Main principles of corporate governance are: consistency, responsibility, accountability, fairness, transparency, and effectiveness that are deployed throughout the organization. Companies have an influence in mobilizing not only their own resources, but also the resources of others in the value chain. Therefore **consistency** of the policies creates the right expectations in the value chain and helps the value chain to be stronger as a whole.

In order to create value, a balanced risk taking and making difficult decisions on a timely basis are essential. Therefore, decision makers at all levels should assume the **responsibility** to take initiative and be **accountable** for their decisions. Each decision requires balancing the interests of different stakeholders. Those who are deemed to be **fair** in their decisions are able to establish longer term relationships which are critical for long term sustainable development.

Every company needs to gain the trust of others not only for financial resources, but also for all other resources that it uses to create value. Trust can only be gained with **transparency**. Unless the mobilized resources are used effectively, it would not be possible to mobilize additional resources. Therefore, **effectiveness** and the communication of effectiveness are critical for long term success.

As each decision maker within the organization has an important role in establishing the reputation of the corporation, **deployment** of these principles throughout the organization is important for having successful corporate governance.

Need for a Model

Good corporate governance is very important for economic development, not only for the individual company, but also for the economy as a whole. Therefore, quality of governance should be continuously improved and good governance should be promoted. However, what is not measured, cannot be improved. Hence, there is a need for a model to measure the quality of corporate governance.

Most attempts to measure the quality of corporate governance focus on compliance related issues. The various rating models also seem to focus on the inputs of governance, such as the composition of the boards, the separation of the CEO and Chairman roles. But do not pay sufficient attention to quality of information and decision making processes, or output measures such as the brand image, employee and customer satisfaction indices, or profitability and value creation. Also, most measures fail to incorporate any inter temporal measures of learning and development in governance.

Therefore, we have developed a Corporate Governance Model® that tries to remedy these shortcomings. The essence of the Model is to evaluate how the "CRAFTED" principles are applied to the "LOGIC" of governance. (Oversight, Guidance, Information, Culture, and continuous Learning)

The Model aims to incorporate not only structural aspects of governance such as the composition of the boards, but also behavioral aspects such as the evaluation of sufficient number of alternatives in decision making, the quality of information that forms the basis of sound judgment, the culture of decision making, the processes, and the results of oversight and guidance functions of the board of directors.

The Model also seeks to check whether if there is a sound, integrated approach to governance; whether the determined approach is deployed systematically throughout different processes and levels of the organization; whether the approach to governance brings the desired results and the results are benchmarked with best in class examples; and whether if there is a continuous monitoring of results that feeds into learning and improvements.

Dimensions of the Model

Corporate governance is a management culture rather than a list of codes. "CRAFTED" governance principles are the backbone of the Model. But the Model does not use corporate governance principles as a checklist, rather the Model tests how these principles are applied to the main activities of the board such as oversight, strategic guidance, choosing the top managers or board members, and improving its own processes.

The evaluation and backbone of the Model stands on four main areas, three of which are input measures and the last area relates to output measures.

Having the right people on the right team that works with the right processes and that has the ability to consider appropriate and timely information is the key to providing oversight and guidance.

Inputs
- Right People
- Right Team
- Right Processes

Outputs
- Improvement in Business Results

Right People: Personal knowledge, skills, competencies, and experiences directly affect the quality of the board decision making. Personal attitudes and manners also have an important role in strengthening both the team and the processes of governance. Therefore, the ability of the board members to express their opinions independently, to contribute a visionary perspective, and to make sound judgments are critical. Their ability to make the right choices for top management roles is also evaluated.

Right Team: As a role model, the team that makes up the board of directors should ensure the formation and improvement of the company culture with their behavior while executing their basic functions: strategic guidance and oversight. Right Team concept considers subjects like: complementary skills of the members, ability to work as a team, or avoiding group thinking pitfalls, etc.

Right Processes: Processes are applications of standards and identified governance approaches. They involve issues such as how information is provided to the board, how the board agenda is set, what the decision making rules are, what kind of resources are made available to the board, how the board monitors and improves its own performance. In fact board of directors, with its oversight function, has the responsibility to monitor the conformity between the principles and execution.

Improvement in Business Results: Continuous system development has an important impact in corporate learning processes. In monitoring results, one should look at comparisons with budgets, prior accomplishments, peers and best in class examples. Also, trends are as important as the current results. Therefore, positive trends in the business results are considered as an important indicator of success.

The three input areas “Right People”, “Right Team” and “Right Processes” are evaluated in five dimensions. These five dimensions are the grouped as the “LOGIC” of Corporate Governance. As shown with the graphical model, these five dimensions are:

- **L**earning
- **O**versight

- **G**uidance
- **I**nformation, and
- **C**ulture

"LOGIC" of Governance

Culture (Tone at the Top): The tone at the top sets the corporate culture. Therefore, both the conduct of the board members and their decisions and how they communicate these decisions are critical. All the members of the board should support, improve, and guide the corporate culture with their actions.

Corporate culture is the cornerstone of creating trust inside and outside of the company. Implementation of "CRAFTED" governance principles, in all its activities, helps the company in both increasing trust to company and company value. The most important role of the board is to increase company's value by being **fair** and gaining trust of all stakeholders. Boards that develop an appropriate corporate culture, structure, and ensure their sustainability are more likely to achieve better business results that are sustainable.

Such a culture becomes the corporate culture only when it is **deployed** to all the **people**, particularly at the management levels of the corporation.

Board members must have positive criticism attitude in their communication with the management and stakeholders. Positive thinking also has the effect of improving the quality of decision making by increasing the interaction quality and increasing participation of stakeholders.

Information: The information provided through an appropriate process to the members of the board of directors to be considered is a critical input. Quality of the information has an important effect on the quality of the oversight and guidance functions of the board.

Successful corporate governance needs evaluations based on timely and accurate information. The coverage and quality of the information prepared for the board will directly affect the quality of decision making and governance.

The task of the board is guiding the corporation through the assessment of multi dimensional views. For this purpose, the board needs the right information, at the right time.

The two important parameters of the Corporate Governance Principles—**consistency** and **transparency**, should be emphasized when considering information.

From consistency perspective, the approach in information flow to board should be continuously monitored, evaluated, and tested, and when necessary improved.

Transparency and facts based information flow will enable sound decision making and give the opportunity to solve the problems before they get serious.

The **process** of information flow to the board should involve not only financial information, but also forward looking issues such as developments in the values of intangibles, employee and customer satisfaction evaluations, competitive information, comparisons with past performance, budgets, and best of class benchmarks.

Also, in order to make sure that all important matters are properly evaluated an annual agenda setting to cover key parameters such as succession issues, changes in competitive environment, organic and non-organic growth opportunities should be undertaken.

Being fair to all the stakeholders, the board helps develop a corporate culture that motivates active participation.

Oversight: The board oversight over the effective utilization of corporation's assets and resources in line with the corporation's strategy is a critical responsibility. In order to gain the trust of all stakeholders, improve the company value, ensure efficient use of company resources and achieve superior performance, the oversight function must evaluate multidimensional indicators. Since boards have both the role of regulating and controlling the corporation, each of their decisions and the way they are communicated have profound implications for the behavior of the management.

Effective oversight requires a balanced evaluation of risk-reward profile of managements' decision making. Being too risk averse, may imply missing value creating opportunities, while being too risk prone may result in impairment of value. Ensuring an adequate consideration of such judgments by a knowledgeable group of people is one of the main reasons for boards to assume the **responsibility** of oversight.

Also, oversight should be consistent with motivating the management for initiative taking assuming the **responsibility** for their decisions. In addition, effective **oversight** ensures that the corporation is managed in line with the strategic decisions and corporate policies. The **accountability** of the corporation to all the stakeholders and establishing a perception that the competing interests of different stakeholders are protected in a **fair** and well balanced way.

Consistency in decision making is critical for managing expectations throughout the value chain and for effective implementation of decisions. Challenging the alignment of each decision—no matter from which level it was made—with the company's mission is an important tool for effectiveness of internal control systems. Establishing approval levels for different management roles is also a critical input for establishing a sound internal control processes.

Decision makers—from all levels—should be able to provide explanations for the reasons behind their decisions (disclosure responsibility.) Both keeping accurate records and establishing a culture of transparency and learning from mistakes must properly function in order to ensure the sound utilization of decision making authority.

Fairness is important in establishing an effective oversight function of the board. Basing decisions on proper information and ensuring continuous development of internal control systems, helps in establishing a culture of fairness.

Strategic Guidance: A key board responsibility is providing strategic guidance. The essence of strategy is choice. And each choice involves risks. One of the key responsibilities of the board is to make sound judgments about risk-reward equations of the management proposals.

A focused strategic approach and ability to make a difference requires the choices to be **consistent** with each other.

On the other hand, **effective** establishment of the priorities is a key element of corporate success. As resources are inevitably constrained, priority setting is the key to ensure successful implementation of strategic initiatives.

The process of the board for determining the strategies and monitoring the results requires that assessments are available for the effects of each choice for all the stakeholders. Also, making sure that risks and reward potentials are properly assessed is a key responsibility for the board.

The scenario and simulation studies help the boards to make sound assessments and judgments in strategic choices.

Learning: Development of humanity is based on continuous learning. Passion for continuous improvement requires setting hypotheses and targets, establishing processes, implementing these processes, monitoring results, learning and implementing improvements. Therefore, learning will be evaluated under three perspectives.

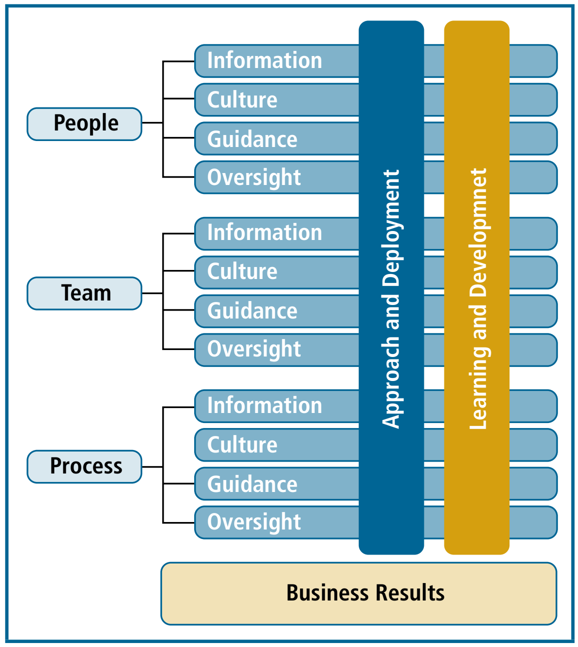
1. Establishing a governance approach and deployment of the approach within the company
2. Continuous evaluation and development of the structures and approach
3. Impact on business results

This Model provides a set of questions and best of class examples of application of the "LOGIC" of governance to the four dimensions of people, team, processes, and business results.

The Model attempts to incorporate not only structural issues, but also behavioral ones and tries to include linkages to a broad range of performance results. It also looks at how continuous improvement processes are implemented in governance mechanisms. The Model incorporates consideration of the right people, the right team, and right process on the basis of corporate governance principles.

A self assessment guide is developed based on the Model (Graph I). The guide attempts to check the coherence of the structure with the board conduct and its continuous improvement processes. Questions are prepared to consider whether in each dimension a proper tone is set at the top; an effective information provision process is established; and a proper process is in place for appropriate guidance and adequate oversight. Furthermore, the developments on these issues both over time and in comparison to benchmarks are considered.

Graph 1.



Answers to these questions are rated according to **BaSICS** of measurement that tries to identify, whether if there is a **Ba**sic definition to which performance would be measured against, the **S**cope is adequate, **I**mplementation is realized throughout the processes and organization, there is **C**ontinuous improvement, and an adequate system is developed and resources are deployed for **S**ustainability. (See Table I)

Table II summarizes the key areas of the assessment guide providing definitions for the subjects to be questioned in the assessment guide.

Summary

Boards have the basic responsibility to ensure sustainable improvements in corporate valuations by providing strategic guidance and oversight over management decisions, as well as selecting and changing the management whenever necessary.

Success of the board depends on making sound judgments in numerous situations that involve balancing different interests:

i. risk vs. reward;
ii. short term vs. long term;

Table I. BaSICS of Measurement

	Based on definition	Scope	Implementation	Continuous Development	Sustainability
C – Culture	Values and principles are defined	Values and principles are perpetuated with applications	Values and principles are disseminated throughout the organization	Implementation of values and principles are monitored to identify improvement opportunities	No leniency when values are breached
I – Information	Timely updated	Comprehensive (dimensions) and Comparable (trend)	Shared and consistent	Best in class benchmarks are considered	Investments are made for information processes and sharing
G – Guidance	Based on information and consistent with the mission and principles of the corporation	Comprehensive (Dimensions)	Establishing the required communication structure for sharing the strategies and objectives	Decision making with the assessment of various alternatives, results and risks	Investments are made for incorporate learning into decision making processes
O – Oversight	Defined processes, principles and rules exist	Comprehensive (Dimensions)	Accountability	Weaknesses in internal control mechanisms are identified and remedied	Confidence to share with stakeholders
L – Learning	Limited examples exist	There are sporadic examples in different dimensions	There are examples that are disseminated throughout the organization	Determining the objectives for learning	Rewarding learning and development

iii. effective oversight vs. motivating management;
iv. ethical considerations vs. market practices; and
v. competing interests of different stakeholders.

Such success can only be achieved in a sustainable basis if the board behaves as a role model for implementing the CRAFTED principles of governance in its own operations and ensures that the corporation follows these principles in making key decisions.

In order to improve the boards' performance, the Corporate Governance Model outlined in this paper[2] may be used for identifying improvement areas and for benchmarking.

[2] A short version of the questionnaire is available at "Boardroom Secrets: Corporate Governance for Quality of Life," by Yılmaz Argüden, Palgrave Macmillan, September 2009

Table II. Key Areas of the Assessment Guide

Dimension	Subject	Definition
Right People	Selection	The members of the Board of Directors should be selected according to key requirements of the corporation based on its development stage, competition, and strategies. Integrity, knowledge, experience, and ability to understand the stake holder expectations and demonstrate sound judgment are among the key personal traits of potential members.
	Development	In order to increase the value added of the Board of Directors, approaches that consider the development of the members individually and as a team should be developed.
	Chairman	The Chairman of the Board determines the climate and conducts the Board in an effective manner. The Chairman stands as an example with his/her conduct to the Board and the corporation.
Right Team	Composition	Selection of new members to the Board should incorporate factors such as good chemistry with existing members as well as having complementary skills to enrich the team.
	Working Climate	The Board establishes team work by creating an open environment of trust and promotes a positive climate for dialogue in order to ensure that all issues are properly challenged prior to decision making.
	Committees	The Board develops a working culture with the committees and therefore, creates ownership for critical processes, improves impact which helps it to use resources efficiently.
Right Process	Agenda / Meeting	Adequate number of meetings that address the right issues on a timely fashion improves decision quality.
	Sharing Knowledge	The Board can succeed in guidance and oversight tasks only when it establishes appropriate systems of information flow to the Board and if there is an open climate for discussion of the challenges of the company.
	Self Assessment	The individual and team performance of the Board of Directors should be measured and development areas should be identified.
	Decision Making & Empowerment	For the purpose of guidance, the Board understands its role as the key decision platform for major issue, the establishment of key principles, and empowerment of the management.
	Guidance for the Management	The Board does not manage, but guide the management. The Board observes the potential, performance and motivation of the executive management and provides direction accordingly.
	Strategy & Risk Management	The Board with multi faceted information flows and assessments from wider perspective understands the risk reward equation of the strategic choices. The Board ensures that there is an adequate risk management system.
	Oversight	The Board ensures to set the right tone at the top and makes sure that there are effective internal control mechanisms and there is an independent audit process as well as adequate processes for fraud detection, including robust whistle blowing procedures.
	Performance Management & Succession Planning	The Board evaluates the performance of the top management basis both in comparison to plans as well as benchmarks. How well the Board follows the internal and external pipeline for executive management is a key element of being prepared for succession planning.
	Communication	The Board provides appropriate guidance and oversight with a positive and motivating attitude.
	Relation with Stakeholders	The Board understands and considers the key expectations of the major stakeholders.

(*continued on next page*)

Table II. Key Areas of the Assessment Guide

Dimension	Subject	Definition
	Sustainability Management	The Board supports and leads the development of the corporation with a view towards its sustainability.
	Investments	The Board assesses the Investments of the corporation as the future building blocks for the corporation, and considers its alignment with the mission, vision, and the strategies during the decision and implementation stages.
	Customer / Product Pipeline	The Board understands the new customer and product pipelines and ensures that there is sufficient investment in developing the future of the corporation, including the intellectual assets.
Results	Improvement in customer satisfaction	
	Improvement in supplier satisfaction	
	Increase in brand value	
	Increase in market share	
	Improvement in product development performance	
	Increase in turnover and profit	
	Increase in turnover and profit per customer	
	Increase in turnover and profit per employee	
	Increase in public awareness of the company	
	Credit Rating	
	Position in corporate governance rating	
	Position in Corporate Social Responsibility Rating	
	Share of new products/ customers in total profit	
	Realization of approved investments according to feasibility studies	
	Learning and improvements achieved	

About the Author

Dr. Yilmaz Argüden is a leading strategist, advisor, and board member of major public and private institutions, and NGOs. He is the Chairman of ARGE Consulting, a leading management consulting firm based in Istanbul, which has been recognized at the European Parliament as one of the best three companies 'shaping the future' with its commitment to corporate social responsibility and is the first Turkish signatory of the Global Compact. He is also the Chairman of Rothschild investment bank in Turkey. He has served on fifty different boards and is currently the Chairman or member of corporate governance committees of Coca Cola Icecek, Vestel, Yazici Holding, and Inmet Mining based in Toronto. Dr. Argüden is a member of the Forum’s PSAG.

Dr. Argüden is an Adjunct Professor of Business Strategy at the Bosphorus University and the Koc University; an author of numerous books and a columnist focusing on business and strategy issues. He is a recipient of numerous leadership, distinguished citizenship, and career awards, and was selected as a Global Leader for Tomorrow, by the World Economic Forum for his commitment to improve the state of the world.

OUR MISSION:

Established in 1999, the Global Corporate Governance Forum is a multi-donor trust fund facility located within IFC Advisory Services. Through its activities, the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crises, and provide incentives to corporations to invest and perform efficiently in a socially responsible manner.

The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform programs.

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