

Critical Factors in Successful Corporate Governance

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Abstract

It is hypothesized that a root cause of the success or failure of an enterprise is directly related to the quality of its board of governance. This quality is reflected in the experience, leadership skills and utilization of the board members as well as the board processes. This paper describes an ongoing research project that identifies potentially critical factors for successful corporate governance including the following: Information, Communication, Governance board policies, Individual board members and Governance processes. Company examples from the literature that exemplify these factors are discussed. An additional objective of this research is to determine whether successful governance could and should be taught. It is believed that the field of Engineering Management is a primary vehicle to educating present and future engineering professionals about successful corporate governance.

Introduction

Corporate governance is a timely and important subject. The business school academic community has recognized this importance and expanded its research efforts in this area. The number of publications involving corporate governance issues has increased over the past decades. It is time that the engineering management academic community recognizes the importance of corporate governance in enterprise success and begins to educate engineering students in successful corporate governance. It is necessary to realize that it is just as important for top management to be aware of the inner workings of the company as it is for employees to be aware of their company's governance board and its workings. An understanding of successful corporate governance will aid future engineers in their potential positions as board members or support personnel. Attempts are being made to gain an understanding of how the success of the board of directors affects companies.

Excellent governance is a priority for almost every institution. Governance boards can be found in corporate, academic, economic development, philanthropic and health care institutions. Engineers serve on or support the governance boards at all of these types of institutions. The modern board is responsible for overseeing business strategy development, hiring the best CEO and executive team possible, requiring adequate information, control, and audit systems, ensuring compliance with legal and ethical standards and preventing and managing crises.³

The Research Project

An ongoing research project is being conducted at the University of Pittsburgh by investigators in the Department of Industrial Engineering and the Graduate School of Business to examine the

critical success factors in successful corporate governance. It is hypothesized that a primary cause of enterprise success or failure is directly related to the quality of its board of governance.

This research project is broken into four life cycle phases: Conceptual, Background development, Data collection/integration and Synthesis/technology transfer. The Conceptual phase involved organizing the research team, developing preliminary research strategies and hypotheses and beginning the literature search. This phase has been completed. The Background development phase focuses on examining the existing literature. A comprehensive bibliography of related studies will be completed and company examples of varying governance success will be identified. A preliminary success model will be built. At this time, the research project is currently in this second phase. The third phase involves Data collection and integration. Data will be obtained through questionnaires and personal interviews with governance personnel. The success model will be finalized based on the obtained information. The last phase, Synthesis/technology transfer, will be to disseminate the research findings to the academic and industry communities. This will be done through course development, presentations and publications.

Preliminary critical success factors have been identified in order to begin to measure the quality of the board of governance. These potential critical success factors are:

- Information* – such as quantity, quality and timeliness;
- Communication* – such as channels and protocol;
- Governance board policies* – such as selection and tenure of board members;
- Individual board members* – such as participation, commitment and characteristics; and
- Governance processes* – such as use of committees, board meeting procedures and decision making.

Information

The quality and quantity of information supplied to the board is of extreme importance. Most boards are given only perfunctory information such as historical financial results.² Information should be timely, relevant and accurate. Directors should receive pre-meeting materials that allow them to prepare prior to the meeting. These materials should include an agenda of the upcoming board meeting and pertinent information required to discuss agenda items. Corporate boards should be informed about the current external environment, their competitor's strategies, their company's strategies, resource deployment, customer satisfaction and the business model.² Boards must receive information from various sources including outside stakeholders, customers and employees.³

After decades of excessive spending, rapid expansion and poor decision making, Allegheny Health Education and Research Foundation (AHERF) filed for bankruptcy in July 1998. The directors were unable to adequately review and assess the documents that were prepared for each board meeting. At times, these documents consisted of more than 1,000 pages of information.⁵

A primary goal of an engineering manager is to efficiently and effectively collect, maintain and present information. These managers need to be aware of the informational needs of the governance board to fully contribute to the success of their corporation.

Communication

Communication takes place among the board members, between the board members and the CEO and between the board members and other management and support personnel. Poor communication in any of these areas can severely affect the success of a corporate board. Board members must be provided with an atmosphere that allows members to talk freely, react candidly and learn from others.² This can be achieved, for example, by allocating meeting time for open discussion as opposed to adhering to a tight schedule filled with “one-way” presentations to the board members. Although the communication between the CEO and board is believed to be of extreme importance, there are differing opinions regarding how to achieve effective and efficient communication. Some advocate that communication is enhanced when the CEO assumes the role of the chairman of the board. This would obviously eliminate any communication problems that might have existed between the CEO and an outside chairman. Others believe that directors may communicate more freely with the chairman if he/she is not the CEO. Conger, Finegold and Lawler³ advocate that a separate CEO and chairman can also contribute to board independence. Charan² suggests that a separate chairman and CEO can lead to personal rivalries and blur accountability in addition to ineffective communication. Separate position of CEO and chairman of the board could lead to confusion over decision-making authority.⁴ Communication between the key personnel and the board of directors should be two-way. Key personnel involved in important agenda items should give short, pertinent presentations to the directors. These presentations should be brief, allowing for questions to be answered and discussion to take place.² Charan² also points out the valuable resource that board members can provide to the company’s personnel in the way of knowledge- and experience-based advice.

Many corporations have begun to make clear and effective communication a top governance priority. General Motors has board guidelines empowering directors with the right to ask any employee for information.⁷ At the Home Depot, directors obtain direct feedback from customers and employees by regularly visiting stores.⁷ Bernard Marcus,⁸ chairman of the Home Depot, states that directors typically visit eight stores every quarter to find out how customers feel about the business and how employees feel about the company and their working environment.

Excellent communication is a requirement for all successful engineering managers. Effective communication techniques should be taught to all employees. An awareness of the intricacies of board communication can help engineering managers to contribute to successful governance of the corporation.

Governance board policies

Many organizations have numerous directors. Charan² suggests that a smaller size board can lead to better board dynamics and improved communication. A size constraint may limit the expertise and diversity of the board members.⁴ Companies should investigate what size board can adequately serve their needs. Corporations may want to institute term limits for their board members. As with any institution, commitment and participation of the directors may begin to subside over time. Conger, Finegold and Lawler³ state that “a board’s power is a function of the backgrounds of its members and the way they are chosen”. These authors recommend that a committee of independent directors should be responsible for selecting new directors.

John G. Smale,⁸ the nonexecutive chairman of the board of General Motors, provides insight into their boards composition. He states that GM's 14-member board is "large enough to achieve a diversity of desirable experiences and backgrounds and small enough to function efficiently".

A working knowledge of good governance board policies is required for top engineering managers who serve on corporate boards. An understanding of board policy dynamics will contribute to successful governance.

Individual board members

Individual board members possess knowledge, skills and experience. It is necessary that the combined knowledge and experience of the board match the strategic demands facing the company.³ Recent trends have seen attempts to diversify boards in many facets including race, gender, experience and age. There has been conflicting results in the literature regarding board composition. Bhagat and Black¹ found that the percentage of independent directors does not affect future firm performance. In contrast, Millstein and MacAvoy⁶ found a significant correlation between active and independent boards and superior corporate performance. Firstenberg and Malkiel⁴ stress the positive role of independent directors by expressing that they should comprise the entire board, with the exception of the CEO.

John G. Smale of GM⁸ explains that, currently on GM's board, the CEO is the only inside director. The remaining directors are independent, reflecting a belief that the board cannot perform its function as independent auditor of company's management if the majority of its directors are also members of that same management.

The goal is to represent a variety of backgrounds, opinions and characteristics while maintaining the ability to work effectively in a group as a team. Engineering managers gain knowledge and experience of group dynamics throughout their education. Engineering Management educators should continue to advocate teamwork in their classroom. Good team skills are imperative throughout the corporation.

Governance processes

Assessment is important in any process to provide valuable feedback. It has been suggested that boards of governance institute formal evaluation in order to improve board performance. In a study conducted by Conger, Finegold and Lawler,³ directors reported that "after they initiated board evaluations, their meetings went more smoothly, they got better information, they acquired greater influence, and they paid more attention to long-term corporate strategy". The number of committees operating within a board should be small. Charan² recommends three committees; audit, compensation and governance. This author believes that too many committees can lead to scheduling problems and poor communication. Many corporations schedule meetings that are packed with presentations leaving little time for discussion and decision making. These meetings are often too frequent, brief and poorly organized. A growing number of boards have begun to limit the number of meetings to six per year.² These meetings typically last longer than six hours and are informally structured. Pound⁷ provides a model of an efficient decision making process. He defines this model as a *governed corporation* which reconnects

shareholders and board members to the decision making process. In a *governed corporation*, directors help managers make the best decisions and major shareholders express their opinions about corporate policies and decisions to senior managers and the board.⁷

Amoco Corporation and Motorola are two corporations that are effectively evaluating their governance boards.³ Both companies require directors to rate their board's performance on multiple criteria specified in a questionnaire and to respond to open-ended questions regarding board performance. Ceridian Corporation, a defense electronics and information service provider, has progressed toward the *governed corporation* by instituting a decision process where board members and major investors are strongly connected and participatory.⁷

Engineering managers are trained in time management and assessment through evaluative feedback. These skills can once again contribute to successful corporate governance.

Educational Dissemination

Because of the importance of corporate governance in engineering management education, a critical element of this research project will be its dissemination. Plans are being made to disseminate the results of this research in the following manner:

Presentations – Presentations in educational seminars, corporate seminars and professional society meetings (such as the ASEE Conference) will be utilized to disseminate work in progress as well as final research results. This form of dissemination is particularly beneficial in soliciting feedback and constructive criticism while the research is on going.

Papers – An obvious outlet for scholarly work is to share the results with colleagues via refereed conference papers, magazine articles, refereed journal articles and potentially an annotated bibliography.

Books and Reports – In addition to a final project report, the research team is in the process of putting together a book proposal. There are two distinct types of books that could result from this research: a textbook and a casebook. Both of these books can be used to supplement a formal course on the subject. The advantage of these books, together with instructor's notes, is that the body of knowledge becomes easily portable into engineering management programs at other institutions.

Courses – Plans are underway to develop a graduate course on the subject of corporate governance. At the University of Pittsburgh, this course would be developed jointly with the Department of Industrial Engineering and the Graduate School of Business. Because of the nature of the subject matter, it is felt that the course would be at a graduate level. We would hope to also develop one or two modules that could be presented in an undergraduate level course. In addition to formal coursework, we plan to develop a continuing education course and workshop for working professionals. These workshops would be geared towards upper level managers, i.e., ultimately current and future board members.

Counseling – A final dissemination vehicle would be to work closely with boards of directors and senior managers in their efforts to successfully govern their corporations.

Conclusions

The following potential critical success factors for corporate governance have been identified: Information, Communication, Governance board policies, Individual board members and Governance processes. The underlying concepts behind these factors are currently being taught in the Engineering Management curriculum. We believe that these concepts can and should be taught in the context of successful corporate governance. Educating engineering professionals about corporate governance can lead to greater awareness of and success in corporate governance.

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