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A holistic model of corporate governance: a new research framework

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Abstract

Purpose – The purpose of this paper is to propose a new model of corporate governance that is holistic – incorporating internal and macro perspectives across legal, regulatory, sociological, ethical, human resource management, behavioural and corporate strategic frameworks. Researchers have signalled the need for “new theoretical perspectives and new models of governance” due to a dearth of research that is context-driven, empirical, and encapsulating the full spectrum of reasons and actions contributing to corporate crises.

Design/methodology/approach – The approach consists of theory building by reviewing the literature and examining the gaps and limitations.

Findings – The proposed model is a distinctive contribution to theory and practice in three ways. First, it integrates the firm-specific, micro factors with the country-specific, macro factors to illustrate the holistic nature of corporate governance. Second, shareholders and stakeholders are shown to be only one component of the model. Third, it veers away from singular approaches, to dealing with corporate governance using a multi-disciplinary perspective. The paper argues that such a holistic and integrated view is a necessity for understanding governance systems.

Research limitations/Implications – The challenge is to operationalize the model and test it empirically.

Practical implications – The model is instructive and of use for practitioners in attempting to understand, explain and develop governance models that are appropriate to their national and industry settings.

Originality/value – This paper argues that narrow-based models are limited in their approach and in a sound and integrative review of the up-to-date literature contributes to theory-building on corporate governance.

Introduction

Even as corporate governance is emerging as an increasingly crucial area of modern management due to corporate meltdowns, frauds and criminal investigations (Jensen, 2001; Monks and Minow, 2004:1), researchers have signalled the need for “new theoretical perspectives and new models of governance” (Daily et al., 2003, p. 371). Empirically, there is
a dearth of research that encapsulates the full spectrum of reasons and actions contributing to the crisis that corporations are finding themselves in. The research that is conducted tends to focus on regulation and the burgeoning control industry surrounding accounting, auditing and legal frameworks. Moreover, the research is often not context driven lacking a broad international focus. Furthermore, it is often conceptual in nature with authors proposing a singular approach through new regulatory frameworks, new decision-making processes or new approaches to learning.

We propose that such approaches do not provide the complete picture. Indeed, Cutting and Kouzmin (2001) state that the term “corporate governance” has been unduly constrained by many commentators to mean only the regulatory and administrative framework that defines the composition and operation of the corporate boards of public companies. The purpose of this paper is to propose a new model of corporate governance that is holistic in its approach – incorporating internal and macro perspectives across legal, regulatory, sociological, ethical, human resource management, behavioural and corporate strategic frameworks to increase our understanding of why such events transpire as well as how to prevent further occurrences.

The paper will first set out the background and importance of governance research. Second, it will discuss various frameworks that researchers have used in their study of governance. Thirdly it will argue for a multi-theoretical approach to the study and in doing so present a new model of governance useful for academics and practitioners in increasing their understanding of the area of corporate governance.

Background of study

With the occurrence of the corporate failures in the USA and elsewhere in the last decade, there has been an increasing focus on governance with several types of frameworks used to analyse the system including regulation, both internal and external (see Jensen and Meckling, 1976), behavioural (see Leung and Cooper, 2003) and decision-making (see Pech and Durden, 2004) including power (see Cutting and Kouzmin, 2000, 2001, 2002; Handy, 1978; Pfeffer, 1992) and ethics (see Francis and Armstrong, 2003; Lagan, 2006; Svensson and Wood, 2004; Wood and Callaghan, 2003; Wood, 2002, 2005). Others examine governance with the aim of addressing the needs of different groups of stakeholders such as shareholders (Lynall et al., 2003), employees (Deakin et al., 2002), customers (Lines, 2004) or society (Jensen, 2001). Others have examined governance systems from contrasting perspectives such as the shareholder versus stakeholder models, and market versus control models (Jensen, 2001; Sharma, 1997).

Traditionally, as proposed by agency theorists (starting from Berle and Mean's, 1932 work and including others such as Eisenhardt, 1989; Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976), corporate governance has focused on mechanisms and rules designed to align the interests of the owners of capital and the managers of corporations. Research in this area has therefore typically focussed on the agency relationship and such mechanisms as types of ownership (Edwards and Hubbard, 2005), financial disclosure (Botosan, 2005), methods of compensating directors and executives (Jensen and Murphy, 1990; Martin, 2005; O'Connor et al., 2006), audit committees and board structures (MacAvoy and
Millstein, 2005; Monks and Minow, 2005) to name a few. These rules encompass procedures to elevate the importance of disclosure, openness and information, transparency, legitimisation, participation and checks and balances (Holmstrom and Kaplan, 2005).

This regulatory approach tends to be prescriptive in nature, advising on solutions to situations after the crisis has occurred. In this regard it centres on the question of “what” and “how”, such as how to set up effective governance? And what systems of governance should be used? In contrast behavioural and decision-making approaches focus on the “why” question. Why were governance mechanisms ineffective? Why did boards and managers act in the way they did? In answering such questions, behavioural approaches are often regarded as a useful addition to the often-used regulatory approaches. In this vein, Leung and Cooper (2003) argue that recent trends to focus on a regulatory approach, neglects other considerations. They argue that the rise in economic rationalism and the related increase in materialism of the public, and company directors and managers have fed the corporate excesses. Wealth transfer to cliques of rich shareholders alongside transfers of power has allowed them to appoint directors, managers and auditors who they can control. Moreover, CEOs have awarded themselves unprecedented pay rises with a growing gap between highest and lowest paid employees (Leung and Cooper, 2003, p. 507). They cite Knott (2002) in arguing that some auditors have forgone ethics in return for record level fees and commissions. In their examination of failure of governance they point to common issues: the opportunistic behaviour of directors and managers in pursuing self-interest and undermining corporate governance mechanisms; failure of transparency and integrity in performance measurement and management compensation; and failure of some corporate watch dogs (Leung and Cooper, 2003, p. 510). They conclude by questioning (Leung and Cooper, 2003, p. 514) whether the corporate accountability laws will solve problems of such self-interested behaviour and the unhealthy shift in attitudes in the corporate world. Cassidy (2003) articulates this view in his paper where he traces the history of corporate governance in Britain during the last decade and concludes that the essence of better corporate governance has been “hijacked” by large accountancy firms, resulting in an undue emphasis on achieving financial goals and compliance with codes of practice, or mere “box-ticking”. Thus, he surmises that in the drive to maximize shareholder value, the regulatory approach has been to the detriment of critical relationships with employees, customers, suppliers and the community and long-term shareholder value has been destroyed.

Furthermore, there are very few studies actually using the evidence from corporations to develop a model which could be used as a broader framework for analysis (for exceptions see Healy, 2003; Robins, 2006; Aguilera et al., 2006). And those that do, discuss it from the perspective of firms-in-crisis rather than factors that contribute to the wide array of governance practice. For instance Mardjono (2005) investigates the corporate collapses of Enron and HIH and concludes that even though these companies acknowledged good corporate governance as a prevailing framework, the failure was in its implementation, explaining that the corporations used governance principles as tools for investor relations to keep stock prices high for the benefit of the boards (Mardjono, 2005, p. 282). She concludes that “had Enron and HIH not departed from good governance frameworks...these giants may have remained...” (Mardjono, 2005, p. 282). But again that brings us back to the question of Why?
As O'Connor et al. (2006, pp. 44-45) conclude from their research into CEO incentive compensation as a major element of corporate control, “the effects of governance mechanisms on managerial behaviour are more complex and more interactive than has been hypothesised” and that “many corporate governance issues warrant further research” (O'Connor et al., 2006, p. 495). Moreover, Durden and Pech (2006, p. 84) argue that regulatory, reporting and disclosure changes actually may bring about increases in costs, reductions in decision speeds and flexibility and, indeed, hinder senior management in their core task of adding value to their organisations. To overcome such unintended outcomes, they argue that corporations may need to devise informal and less prescriptive systems to support and reinforce corporate governance practice (Durden and Pech, 2006, p. 94). In support Clarke (2006, p. 8) quotes one Australian chairman’s response to his country's reforms: “Boards and CEOs will become risk averse and restrain the world economy to the detriment of us all”.

It is clear that a more holistic governance model would be a worthwhile addition to the study of corporate governance. The focus on prescriptive approaches requires broadening to incorporate behavioural and multi-disciplinary perspectives. But first a review of the research that has been conducted using the myriad of frameworks is useful starting point to the discussion.

**Behavioural frameworks of analysis**

Behavioural perspectives include a variety of factors that impact on governance systems and the actions of the parties in the system. These include power and self-interest, gender, decision-making, learning, personality, groups, leadership, culture and values. These are particularly important in improving our understanding of the role and activities of the board. Board behaviour and decision-making structures, board networks, and the effect of board composition such as part-time versus full-time members, executive versus non-executive members, ethnic diversity and gender, are all important considerations in this regard.

Cutting and Kouzmin (2000) argue that corporate boards are failing to serve their companies effectively due to apathy and ignorance of company affairs and a negligence of fiduciary duties. They refer to the corporate collapses and observe that the board did not know what was going on. Questions were not asked, directors were operating in ignorance, simply agreeing with CEOs' decisions. As such, they argue “that corporate decision-making processes can usefully be viewed as simultaneously comprising a political process, a learning process and a process involving individuals” (Cutting and Kouzmin, 2000, p. 14) and that the principles and guidelines for corporate governance should be re-designed on the basis of understanding the dynamics between the three parties of executive, shareholders and judiciary and other rule makers. Cutting and Kouzmin (2001, 2002) in discussing the dynamics of the process incorporate dimensions of individual personality, leadership style, group roles and group-think, leader-follower dynamics, and openness to learning.

Similar concepts to Leung and Cooper (2003) and Cutting and Kouzmin (2000) have been discussed by Pech and Durden (2004) when they argue that a raft of corporate failures have been caused by managerial decision-making processes that have destroyed the integrity of the organisational learning experience though the corrupt and dysfunctional behaviour of
the managerial elite. They state that “organisations need to build a culture of knowledge sharing in which senior managers and, indeed all members of the organization, are connected to and remain connected to the collective consciousness” (Pech and Durden, 2004, p. 73). In this way it is claimed filtered decision making processes can be minimised. As Cutting and Kouzmin (2000) claim the important thing is that board processes allow continual learning to occur, asking pertinent questions and maintaining a spirit of enquiry.

Similarly other researchers refer to culture as a determinant of good governance and its implications for the role of the board. As Thornbury (2003, p. 1) states: “where companies do not have a statement of values, or where the values are not accepted, there is a real danger that company staff will act in their own interests, not in the interests of the stakeholders they are meant to serve. At this point they may put at risk the reputation of the whole organization”. Since the board is the senior most level of management in the firm, and culture is usually set from the top management, it is reasonable to accept Cutting and Kouzmin’s (2000) argument that it is the board's responsibility to ensure that there is a learning culture and that “the processes of the board (and the corporation) should be encouraging the development of a greater understanding of their reality and stimulating the creation of new knowledge”.

Increasingly important is the board's strategic role with Kemp (2006), for instance, observing that the increased expectations from a range of stakeholders including employees, regulatory agencies and shareholder activist groups, are forcing boards to increase their involvement in strategy formulation, strategic decision making and strategic control. However, she claims empirical data from Australian companies reveals that involvement of board members in strategy “is not equal” and is conditioned by several factors including board members' interests, experience, past decisions, informal relationships and ties with other board members, and established board processes. A deeper level of involvement is possible only if the board as a whole is willing to engage in constructive conflict as a team and address decisions comprehensively.

Westphal and Milton (2000) mention that firms are being pressured by stakeholders to also appoint directors with different ethnic backgrounds, gender and expertise with the expectation that this would lead to less insular decision-making processes and introduce a greater recognition for change. Independence and decision-making should be enhanced through appointing board members from a variety of social networks they claim, thus breaking social ties with existing directors.

In a similar vein, a study conducted by Sheridan (2001) surveying women board members of publicly-listed companies in Australia found that seventy per cent of respondents felt that the professional experiences and backgrounds of board members was inadequate and requires to be enhanced through diversity. She found that networks and “who you know” were important for women to gain access to boards with 48 per cent of respondents believing that organisations were afraid to appoint women who were not already on boards and 46 per cent believing organisations did not know where to look for qualified women. Further research she claims is warranted in uncovering how corporations can gain access to the most effective range of skills for effective governance.
However, changing the composition to increase diversity alone may not lead to better organisational performance. For, as Van der Walt et al. (2002, 2006) point out, board composition will vary according to the life cycle stage of the firm, the strategic implications of the operating environment, and the type of ownership structures and their associated governance, performance and social requirements. This interconnectedness among several variables underscores the need for approaching the issue of boards and corporate governance in a comprehensive and holistic manner.

In heightening the importance of behavioural approaches as opposed to regulation, which they believe is limited in its usefulness and is increasingly being questioned, Du Plessis et al. (2005, pp. 368-382) explain the role of directors and managers as stewards or guardians through a discussion of norms of behaviour. The stewardship approach proposes that managers do have similar interests to the corporation, in that the careers of each are linked to the attainment of organisational objectives and their reputations are interwoven with firm performance and shareholder returns (Davis et al., 1997). Whereas the Resource Dependency theory is useful in addressing the role of directors as boundary spanners between the organisation and the environment (Pfeffer and Salancik, 1978). Directors' professional appointments as lawyers or bankers, for example, enhances organisational functioning by providing access to resources needed by the firm.

Hence, while the corporate governance literature has investigated the role of the board in quite some detail and presented various theories such as agency theory that focuses on monitoring, the resource dependence theory that concentrates on the board providing access to resources, and the stewardship theory which focuses on the board's strategic or advisory role, it is evident that no single theory in isolation can provide a complete understanding of the board's role (Daily et al., 2003; Lynall et al., 2003; Nicholson and Kiel, 2004). The role, composition and behaviour of the board cannot be analysed in singularity and their inter-relationships and impact of other variables requires further analysis.

Hence, we need to look at different approaches to decision making to improve our understanding of the aims and objectives of each of the parties and how they can be more closely aligned. Although there are common themes across the agency and behavioural approaches in their discussion of goal misalignment between the organisation, directors and managers, they differ in how to bring them together. As Eisenhardt (1989, p. 63) argues even though agency and political perspectives assume the pursuit of self-interest at the individual level and goal conflict at the organisational level (for instance, March, 1962; Pfeffer, 1981) the differences lies in the former resolving it though incentives or the price mechanism of economics, while the latter resolves it through bargaining, negotiating and coalitions.

**Business ethics and corporate social responsibility**

Other researchers have focused on ethics as an important component of culture, values and decision making in their examination of corporate governance. Even though “business ethics” has been evolving since the latter half of the twentieth century, it is only in the last 15 years has it emerged as a distinct and high-profile area of corporate concern and academic interest for instance in Australia (Wood, 2002). Lagan (2006, p. 72) claims that
organisations need to manage the ethical dimensions of their business due to “increasing governance regulation, a cynical media and pressure from environmental and social agitators, as well as the increasing complex world of work inside corporations”. Indeed, regulation prescribes organisations to actively engage in ethics in setting up governance frameworks with, for instance, the Australian Stock Exchange (ASX) Corporate Governance Council incorporating ethics as a major component. Its principle number 3 is to, “actively promote ethical and responsible decision-making”, and “clarify the standards of ethical behaviour required of company directors and key executives ... encourage the observance of those standards ...” (Australian Stock Exchange Corporate Governance Council, 2003, p. 28).

Wood (2000, 2002, 2005) has examined codes of ethics, primarily in Australia, as one aspect of ethical behaviour, arguing that the code is an “important artefact that announces to all that the corporation has an interest in business ethics (Wood, 2005, p. 41). Although, the limitations in using regulation and codes for promoting ethical behaviour has been highlighted by numerous researchers. For instance, Wood and Callaghan (2003) considered the commitment to business ethics of the top 500 Australian private companies in a longitudinal study conducted over the years 1995 to 2001. They conclude that “companies should not and cannot be judged solely on the existence of artefacts of business ethics that they appear to have in place, but on the effectiveness in the marketplace of their programs on the behaviour of all of their staff, from the CEO down” (Wood and Callaghan, 2003, p. 220). Similarly, Lagan (2006) adds that more needs to done than just signing off on ethical codes of conduct – this includes setting up learning opportunities to ensure there is congruence between personal and organizational values; rewarding ethical behaviour; setting the ethical tone from the top; and empowering employees to raise ethical concerns.

Linking ethics to social responsibility and stakeholders is another important move away from a singular approach. This idea is conceptualized by Svensson and Wood (2004) where they discuss the need for business executives to proactively consider the corporation's view and society's view. They conclude that “a consideration of one's business ethics cannot be left until a major crises arises, for a lack of preparation both philosophically and practically will leave the corporation unduly exposed” (Svensson and Wood, 2004, p. 32). They postulate that “business ethics research would benefit from exploring why companies in the market place continuously fail to maintain a proactive gap of business ethics performance” (Svensson and Wood, 2004, p. 32).

Francis and Armstrong (2003) discuss ethics as a risk management strategy expanding on its relationships with values, strategy, stakeholders and social responsibility. They define ethics as being “concerned with moral philosophy, values and norms of behaviour that guide a corporation's behaviour within society” (Francis and Armstrong, 2003, p. 376). Along with values, they add links to strategy when they argue that successful corporate performance depends on the competitive advantage obtained from managing issues that affect various stakeholders- from employees and customers to government departments and communities and changing societal expectations of business arising from mutual obligation and corporate social responsibility. They conclude that such an approach contributes to stakeholders’ quality of life and leads to increasing profits, reducing fraud, avoiding litigation and ensuring a healthy and safe working environment. They argue that governance principles should include an ethics audit of every major decision implemented. Even though
companies may be complying with legislation, they argue, these are minimum standards only, whereas ethics sets aspirational standards. In this way ethics is a “complement to the law”.

Each of these perspectives proposes internal or firm-specific factors to be incorporated into a new broader framework of governance. This quest for finding holism is observed by Sundaramurthy and Lewis (2003) who explore the dynamic balance among corporate governance imperatives and argue for a fundamental reframing of governance issues “that moves beyond either/or thinking”. In an attempt to highlight the decision-making structures and governance, the authors, citing Demb and Neubaueur (1992), observe that “board members must be independent personalities who can resist “groupthink” and raise critical questions of colleagues”. They also suggested a link between the life cycle of the firm, its external environment, and the decision-making capability and effectiveness of the board. Lynall et al. (2003) echo this idea and contend that the firm's development or organisational life cycle, and the relative power of the CEO and external financiers influence the board formation and composition. This negates a static theory of governance and reinforces not only a dynamic theory but one which incorporates a range of variables, some within the control of the organisation and its board and others more deterministic in nature.

**Macro-perspectives**

This paper has alluded to external or macro-level factors in reference to social responsibility, stakeholders and environment. These macro factors are an important dimension to governance and require a more detailed discussion. Incorporating macro or external factors is important as the organisation, as an open system, interacts with its environment continually, gaining inputs, sending outputs, adapting, reflecting, changing and growing. In this interactive system the importance of stakeholders is acknowledged.

**Corporate social responsibility (CSR)**

An increasingly important element of organisational activities is directed towards meeting the needs of the variety of stakeholder groups, whose activities can threaten the survival of the organisation. These stakeholders exist internally, and include employees, managers and the board and externally, and include customers, government and community. Bonn and Fisher (2006, p. 731) cite several researchers (Boatright, 2003; Carroll, 1999; Fisher, 2004; Robbins *et al.*, 2003; Shaw and Barry, 2004) who argue that businesses have obligations that go beyond profit maximization and should make a positive contribution to society. Those who argue from this perspective believe that corporations have a variety of broad social obligations. This ranges from a minimalist approach such as meeting regulatory and legal obligations to those more broadly focused on philanthropic opportunities such as assisting underprivileged communities and developing countries. Simmons (2004) argues that these responsibilities extend to environmental and social sustainability, incorporating human resource practices and organisational justice, and argues for an ethical governance system that incorporates the needs of a wide variety of diverse stakeholder groups. Hence, the governance practices and principles adopted differ depending on the acceptance of the corporation's view of their social responsibility obligations. Important dimensions to be considered in putting in place a social responsibility framework include internal policies in
areas of human resource and industrial relations, strategy, leadership, values and culture. External dimensions to be considered include how customer needs are met and hence, indirectly considerations of product quality and financial viability; and environmental, social and community activities.

Linking this to behavioural perspectives, Aguilera et al. (2006) in researching the different CSR approaches between US and UK firms draw on Cropanzano et al. (2001) to explain why multiple actors such as employees, top management teams, firm owners, consumers, government and non-governmental organisations acting at multiple levels – as individuals, within firms, within nations, and within transnational organisations and in transnational interactions- push firms to engage in CSR initiatives. They use justice principles to explain the motives of the parties as being instrumental, relational and morality based. Instrumental motives they argue are driven by self-interest, relational motives by status and peer standing, and moral motives by ethics and welfare of larger groups within society.

Galbraith (2006) citing previous work in the literature suggests that CSR is an area of corporate concern that can not be overlooked and is essential to a firm's overall strategy. The author added that although some strongly oppose any responsibility of the firm beyond the economic, research does suggest that CSR beyond just the economic “pays” and that CSR does have a positive financial benefit to firms. Moreover he adds that countries view CSR differently and various aspects including local cultures, regulatory environments, NGOs and global standards are important considerations. Scholars (Buhmann, 2006; Decker, 2004) have also linked CSR with legal structures arguing that CSR acts as informal law, and that important principles of law are embedded in the general set of values which influences the substance, implementation and communication of CSR.

Not just academics, but top management is also very vocal of the nexus between CSR and its positive impact on firm value. Chris Goodyear CEO of BHP Billton states:

The benefits BHP Billiton gets from achieving a high standard of corporate social responsibility are indisputable. Without our reputation as a corporate citizen contributing positively to our communities, there is no doubt our profitability would be hampered and shareholder value destroyed... It's a powerful competitive differentiator. It has the potential to establish us as the company of choice, giving us better access to markets, natural resources and the best and brightest employees. By doing so, we can maximise profits for our shareholders (keeping the Friedman adherents happy) while also ensuring we do the right thing by those who are impacted by our business (Goodyear, 2006)

The link between social responsibility and share ownership, and indirectly to national characteristics, is an interesting one and also worth exploring within the governance debate. Hanson and Tranter (2006) observe for instance that Australia is a share-owning democracy due to the highest proportion of shareowners of any country. For companies in Australia it implies that their direct link with the society is therefore greater due to the vast majority of people involved in their activities.

*National characteristics – their linkages to corporate governance and CSR*
These national characteristics and its links to corporate social responsibility and governance more broadly, are impacted on by each country's legal, cultural and values frameworks. As Aguilera et al. (2006, p. 148) states:

Recognising that firms are situated within a given society and political tradition, which will influence the decisions of individuals within the firm, one can conceptualise corporate governance as relationships within the firm and between the firm and its environment.

The importance of such macro-external variables is specifically highlighted with the OECD (1998) advocating for pluralism, adaptability and flexibility in corporate governance to suit the unique requirements of individual countries. Indeed cultural relativism argues that the standards of conduct vary with the norms and values of the host country; that there is no single moral standard, only local moral practice (Dellaportas, 2005, p. 327).

Cornelius (2005) studied the relationship between the quality of governance practices in several countries and the extent to which the quality levels could offset the perceived weaknesses in the institutional framework (Cornelius, 2005, p. 13). He concludes that while legal institutions play a key role in corporate governance, other factors, such as politics and cultural and historical roots are important. A major implication of his study is that good corporate governance at the company level need not be constrained by the local environment of the firm and decision makers might in fact be able to put in place practices that offset at least partly the weakness in the legal framework.

Notwithstanding this, there seems to be two governance models which most countries are classified into: Those based on “markets” as in the USA and UK and those based on “relationships” as in Japan and Germany (Nowak, 2005, p. 410). History has provided an antecedent to such developments with the Second World War influencing the importance of banks in Germany for example, and the unification of East and West Germany providing a fillip to change. Countries based on socialist principles also exhibit different governance systems with greater government control and restricted stock market activity.

But globalisation has seen a rise in “western” market systems with a greater degree of stock market activity with a corresponding changing reliance on market control rather than bureaucratic control (Monks and Minow, 2004, p. 295). Although others question such convergence of governance systems with Cernat (2004) citing researchers such as Coffee (1998), Moerland (1995) and Mayer (1997) in this debate. And Du Plessis et al. (2005, p. 385) argue that the 1990s move to the more formalised outsider model of US corporate governance by Germany, France and Japan is ceasing after the large-scale US corporate collapses. While Monks and Minow (2004. p. 295) point to differences found within the “western” system in areas of style, structure and emphasis. As Monks and Minow (2004, p. 298) state there can be no “one size fits all” approach and countries’ governance practices cannot be transplanted or imposed on others any more than cultures and legal systems can.

**Stock market cycle**

Proponents of the “western” system of governance argue that market control provides the required checks and balances to ensure optimum governance. But such a system is at the
vagaries of the stock market with all of its own influences. It has been argued that a bubble inevitably results in corporate collapses which leads to a general decrease in confidence in the market with the result that statutory intervention occurs to restore confidence. With confidence comes exuberance with the focus changing from conformance to performance and renewed speculative frenzy (Du Plessis et al., 2005, p. 365). Such a cycle inevitably effects the practices of those involved in governance as well as the types of systems that are developed.

Even so, these views do not undermine the role of regulation. Monks and Minow (2004, p. 531) argue that governance frameworks arise from “differing national frameworks of law, regulation and stock exchange listing rules, and differing societal values”. These can be mandatory or voluntary, linked to listing requirements or merely aspirational.

The necessity for a multi-dimensional perspective

A holistic multi-dimensional approach is required which attempts to capture the full array of variables- those internal to the firm and those part of the broader environment – to understand why certain types of behaviour occurs and to provide a new way forward in governance analysis. Some authors have more recently adopted such an approach. For instance, Aguilera et al. (2006) conceptualizes corporate governance as relationships within the firm and between the firm and its environment; with the environment encapsulating law, labour markets, product markets and capital markets.

Willis (2005) links the macro regulatory framework and guidelines directly to specific processes and practices within firms, and argues that unless firms adhere to sound information and records management, corporate governance will become ineffective. Citing the HIH report which stated that corporate governance is “not limited to the legal controls established under legislation or the general law, but also includes accountability, not only in terms of legal restraint but also in terms of self-regulation and the norms of so-called best practice”, the author summarized the key factors of corporate governance as, direction, leadership and accountability, combined with systems and processes. While direction, leadership and accountability are the roles of the board of a company or the governing body of an organisation, and systems and processes are the means by which they meet those obligations.

Adams (2004) assessed in detail the “reporting-performance” gap, or the extent to which corporate reporting on ethical, social and environmental issues reflected corporate performance, which would indicate the extent to which an organisation is accountable to its stakeholders, and concludes that there is a need for other measures to improve accountability including mandatory reporting guidelines, better developed audit guidelines, a mandatory audit requirement for MNCs, and a radical overhaul of corporate governance systems.

In a similar vein, Robins (2006) use a multi-dimensional analysis to examine corporate governance and categorises problems leading to corporate scandals as technical, political and cultural. The first he argues focuses on accounting, auditing and board responsibilities, the second relating to such political matters as conflicts-of-interest, and the third to the
wider cultural view of ethics, honesty and the law. He states that regulation is only part of the solution with personal standards of honesty and ethics needing to be considered as part of governance.

Each of these perspectives is important in developing a holistic corporate governance framework. They illustrate the broad nature of governance and the need for a framework that addresses the topic in an all-encompassing manner – that extends the analysis from a prescriptive regulatory approach that limits actions, to one that is more descriptive and provides an explanation of why actions occur and decisions are made. Figure 1 presents a preliminary view of the broad issues that will form the components of the proposed model.

As indicated in Figure 1, the proposed model of corporate governance is a distinctive contribution to theory and practice in three ways. First, it embeds the firm-specific or micro-internal factors, within the country-specific or macro-external factors to illustrate that corporate governance at firm-level will fail if not synchronized with the external environment of the firm, and vice-versa. Second, shareholders and stakeholders are shown to be only one component of the model with other important aspects being corporate social responsibility, human resource management, organisational culture etc. Thirdly, it veers away from narrow approaches focussing on legal and regulatory, accounting, ethics and so on, to dealing with corporate governance using a multi-disciplinary perspective. We argue that such a comprehensive and integrated view is indeed a necessity to explain governance systems in the truly holistic sense.

This paper has reviewed the significance of governance research, discussed existing frameworks, and in the light of rampant governance failures, presented a multi-theoretic model incorporating internal and macro perspectives across legal, regulatory, sociological, ethical, human resource management, behavioural and corporate strategic frameworks, to increase our understanding of why such events transpire, as well as how to prevent further occurrences. The model highlighted the wide range of issues that researchers and practitioners need to address simultaneously, and in doing so it exposed the in-built loopholes leading to governance failures when a piecemeal approach is adopted. The governance system has been demonstrated to be a “living system” and an “open system” in that, a change in one variable affects several variables in the system, which necessitates nothing short of a holistic and integrated perspective with a thorough understanding of the linkages among the variables. The paper clearly highlighted that the issues identified and raised are not new. As Becht et al. (2003, p. 5) in their discussion, “Whom should corporate governance represent?” observed, “some of the main issues over which the early writers have been debating remain central today”, such as an enhanced focus on stakeholders rather than only on shareholders, role of employees in corporate governance, and, role of corporate governance in increasing firm value. They cite Dodd (1932, p. 1162) who argued that the interests of employees and consumers come before managers and owners in that:

... business is private property only in the qualified sense, and society may properly demand that it be carried on in such a way as to safeguard the interests of those who deal with it either as employees or consumers even if the proprietary rights of its owners are thereby curtailed.
In conclusion there is strong case for an immediate discussion and debate on the issues raised in the paper. The capitalist and market forces have left an unwanted residue which has now reached massive proportions. Observe this quote by De Geus (1997, p. 9, see Cutting and Kouzmin, 2000), “… managers focus on the economic activity of producing goods and services and forget that their organization's true nature is that of a community of humans”. The model proposed in this paper compels a deeper look within the firm, within the environment, and between the firm and its environment, encapsulating law, labour markets, product markets and capital markets. The challenge lies in shifting corporate governance from a regulatory approach that “limits” actions, to an environment of “self-regulation” and adherence to personal ethical standards that actually requires “pro-active action”. The time has come as articulated by Phillips (2006) where “corporate managers are seeking not just more corporate governance words but a reason for taking this philosophy into day to day management”, and this paper is a contribution in that direction. Future research should seek to operationalize the elements identified in the model, identify and test the direction of linkages among elements and focus on building a robust model that can be easily incorporated into practice.
Figure 1: Preliminary view of basic components in the proposed model of Australian corporate governance

References


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