A New Direction for Corporate Governance: Integrating Accounting with Strategy

"Boards and management in strategy are like two sides of the same coin... If companies have been clapping with one hand so far, perhaps it is time to do so with two."

— Dr Lawrence Loh '77

Codes of corporate governance are drawn in many countries primarily to protect shareholders from the potential vagaries of management. In Singapore, the existing 2000 Code has an eye-well for investors of listed companies. Of late, revisions to the Code have been proposed. The underlying philosophy of the Code, even with the changes, remains intact: Boards of directors represent shareholders (the company's owner) and serve a critical role in regulating the company, particularly in managing the company's business, to whom boards of directors or their representatives provide their interests in the companies and also vis-à-vis the management. This need arises from the classical problem of delegation where the delegating party (principal) has to ensure that the delegated party (agent) serves its interest. Within such a setting, boards focus heavily on monitoring management. This is the case of the so-called "corporate governance". The conventional wisdom is that a board of directors, when properly constituted in line with prevailing codes of corporate governance, will mitigate the risk of damage resulting from self-interested and deviant management. In this light, the focus has been on the "right" structuring of the board and its committees especially in having those being independent from the company or its management. Specific emphasis is accorded to auditing of the financial affairs of the company as well as remuneration determination by top managers.

By and large, the control aspects, through the board of directors have been a basis of corporate governance. These have indeed been the key threats of legislation. The desire is corporate failure prevention or mitigation and an unintended outcome is looking at downside risks more than upside gains. In the emerging business era, however, the factors for corporate success have changed dramatically. More than ever before, the new global knowledge-based competitive environment put changed demands on companies. From a business-centric supervision of companies, corporate governance will have to adopt a more business-centric facilitation of companies.

Hence, corporate governance guides the human capital (managing) and financial capital (board) of the company. Moving forward, it has to steer the business capital (capital), it has to create the incentives for viability beyond survivability. Indeed, corporate governance should be an integral part of the overall value chain of the company, generating sustainable and distinct competitive advantages for the company.

Thus from a pure "accounting" perspective, corporate governance in companies has to embrace a stronger "strategy" perspective. How can corporate governance move towards a strategic approach? Let us look at what the scope of strategy entails. Traditionally, strategy has three interconnected domains: (1) analysis, which consists of an assessment of the external and internal environments; (2) formulation, which develops and selects the alternative courses of action; and (3) implementation, which deals with issues of execution of the selected course of action.

Boards have limited roles in the formulation part. This involves a linear sequence where management, put up strategic alternatives, the board makes or endorses decisions, and management turns implement. Often, the board serves a rubber stamp role especially in situations of management dominance.

Significant concern, not in the best interest of the company and its owners, may creep in first, in terms of the time horizon of decision-making, management may opt for shorter time frames and value quick results over better gains that may require a longer time to realize. Second, depending on the incentive system, managers may take on too much or too little risk. These tendencies may be subtly sighted into the strategy phase and it will take the most vigilant boards to uncover them.

Boards involved in each stage of strategy may reduce the "going concern" notion into each phase. At the same time, optimal return profiles may be encouraged at source rather than after the fact. The portrait of boards may be framed in four roles as follows: (1) Stamper; (2) Shooter; (3) Shaper; (4) Synthesizer (see figure 1).

In a setting of management supervision, the board is a more "stamper" of decisions put up. While boards may attempt to adopt a more direct contribution to strategy, it becomes a "shaper" and often micro-manages the micro foundations.

In the recent rundown to tighter controls particularly on the financial aspects of the company it becomes a "shooter" and focuses on disclosure and compliance by management. Going forward, it will be good for boards to perform an integrative role in both accounting and strategy and assume a "synthesizer" posture.

For a shaper focus on strategy, there will be three requirements. One, novel mindset from management and boards must be in place to embrace the mandate of corporate governance. Up to now, corporate governance is very much indication-based and the tendency is often "check-the-box" and follow the approaches based on the point-by-point guidelines of governance codes. While we cannot dismiss the value of prescribed specifications in dealing with governance, the relative shortfall of interest is often in the intangible urge to fulfill. A strategy-oriented board will go beyond the "let-the-code-and-be-out" posture.

Two, the board-management dynamics can be different. Management must get used to the idea that the board will have a deep interest in the ongoing concern of the company and may demand more information and involvement. It will have to adjust to the new company landscape where the board is a key lever for positive interventions. Formal and informal interactions between the board and management or even other staff will become a norm.

While the situation will be more complex, this is certainly visible in smaller board-management nexus.

Three, new structures such as board-level strategy committees may need to be set up. To properly formalize mechanisms of the board are often limited to an almost audit, remuneration and also some of the top management and board members. Presently there is a trend to have executive risk committees at the board level. Going forward, boards may also form strategy committees that can be formal platforms to handle issues in business strategies with perhaps a sharper attention on company performance. In addition, these committees are ideal forums to discuss the basic assumptions driving the company's strategies and policies. Management may be captured into these committees and these can be won-win partnerships.

Board engagement in strategy, however, must be approached purposefully and insistently. There must be careful calibration and anticipation. Otherwise, the board may actually become regulators and we are back in a square one — who monitors the Worn? With the board's main problem that often inflicts management — governance — has now been tied to the company's core strategy, it will be strange if a board is becoming more like management, and in turn, management is becoming more strategic.

However, on balance, the benefits of board participation in strategy are critical, probably outweighing the costs. The crucial consideration may be the acceptable balance, a critical trade-off that is contingent on and contextualized to the unique circumstances of each and every company.

Boards and management strategy are like two sides of the same coin. They are a dual that is a necessary part of the company's strategic process. If companies have been clapping with one hand so far perhaps it is time to do so with two.

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