The Impact of Cultural Diversity on Board Models and Good Corporate Governance

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ABSTRACT

Corporate governance seeks to lay the foundation for a more mutually beneficial synergy between the business organization and all parties that it impacts on. In this regard it establishes principles that are regarded as acceptable best practices globally in the running of a corporate entity. The Organization for Economic Co-Operation and Development (OECD) has been in the forefront of the setting of these principles. One of the cardinal institutions in implementing these principles and maintaining this standard is the Board of Directors of a corporation. This paper looks at the two kinds of board models prevalent in international corporate practice and concluded that it is not the OECD code per se that establishes these models but rather the culture and cultural orientation pervasive in the society and environment where the corporation does its business that determines the board model adopted.

Keywords: OECD, Board Models, Unitary, Two-Tier, Culture.

1. INTRODUCTION

Business is as old as the society. The early man realized that survival required using what he had to exchange for what he needed. At some point the excess of his production necessitated that not only should he exchange but must also dispose of goods for some gain. Thus the advent of trade, and the establishment of the one man enterprise. The growth of trade and developments in human commercial life brought about the need for regulation of business activities the result of which was company Law. It set the framework for the regulation of the establishment of businesses, and for what purpose.

1.1 Corporate Governance

Human life is anything but static. As a company law strives to deal with the business environment, its lapses began to show. It had effectively, in some climes very strictly, laid the foundations for establishing a business, but began to be found wanting in determining how to effectively do the business set-up. There was the need to have another framework, not necessarily in form of law but rather of principles, as guide to the operations of a business that the law had allowed to come into existence. Corporate Governance has therefore been defined (Shailer, 2004) as embodying "the mechanism, processes and relations by which corporations are controlled and directed". It is about the pursuit achieving the business goals in the context of social, regulatory and market environment. Corporate Governance is referred to as that institutionalized machinery established to guide and superintend corporate operations where company law has stopped. The word institutionalized "becomes pertinent knowing that we can now talk about "good" or "acceptable" corporate governance practices. The word machinery refers to the different Codes that spell out the principles of good corporate governance (Sarbox, 2002). The reason for the last part of the working definition above is borne out of the fact that Corporate Governance principle almost always come to fore to salvage a situation where a crisis has ensued in the corporate world regardless of the subsistence of Company Law.

It then become expedient not to view the legislation governing businesses as all encompassing, but to leave the establishment of Corporations into broad Company Law, and their operation to Corporate Governance. In modern parlance therefore, good corporate governance is the adherence by a corporation to its governance codes, at the forefront of which is the OECD Principle of Corporate Governance. Aoki has quite rightly stated that Corporate governance concern "the structure of rights and responsibilities among the parties with a stake in the firm" (Aguilera and Jackson, 2003, 447).

1.2 Culture

The word culture normally evokes a perception relating in its simplest form to society and tradition. Here E. B. Taylor's definition is the most illustrating "that complex whole which includes knowledge, belief, art, morals, law, custom and any other capabilities and habits acquired by man as a member of society" (Tylor, 1871). The wider connotation of the definition shows that the term culture applies to all facets of human life, including that which an individual is born with, that which he is nurtured with and that which he comes to know. As such, the norm of a particular human endeavor becomes the culture in that field. It represents a set of specific practices within a sub group of a society, that which is inherently accepted as part of the workings of a particular human endeavor.

In this regard, apart from the strict societal angle but still within its ambit, we can speak of business practices as having a cultural annotation. The norms, customs and beliefs inherent in a business environment represent its culture. Culture informs business practices; as regards type of business in a particular environment, the employment practices, values in and of the workforce. In fact, the culture of and in a particular family may determine the kind of business that is engaged in by its members. The focus on culture in this paper therefore is that it is the determinant in the choice of that integral part of corporate governance; the Board of Directors.

2. BOARD MODELS IN CORPORATE GOVERNANCE

The Board of Directors plays a fundamental role in the Corporation and is the most integral determinant of the attainment of good corporate governance i.e. it is the organ directly responsible for the enforcement of corporate governance principles. The Companies Act (UK Companies Act, 2006) imposes on Directors the following duties:

- To act within powers (i.e. the duty of performance)
- To promote the success of the company
- To exercise independent judgement
- To exercise due diligence, reasonable care and skill
- To avoid conflict of interests (embedded in this are the two duties not to accept benefits by virtue of their position from third parties; and the duty of Disclosure).

The Board functions primarily to oversee the affairs of the company and to govern the organization by establishing its general policies and objectives and the structure to establish those objectives. The specific legal responsibilities of the Board may vary from one organization to the other but the underlying responsibility remains the same. The Board must therefore be structured in a manner tailored towards achieving its organizational goals in conformity with good corporate governance principles. Thus the choice of a model of the Board best suited for the organization. Board models therefore refer to how the Board is structured to best govern the organization. One major determinant of the choice of a model in any organization stems from the Agency theory.

In the general context, Directors as agents have a duty i.e. to direct. The Agency Dilemma question is then whether the loyalty of the Directors is to the Company itself, or the shareholders and or stakeholders; or their own interests. To circumvent this doubt, the Corporation adopts the model of the Board most suited to protecting the vision envisaged as its fundamental aim. It has been aptly stated "Governance is the combination of policies, systems structures and a strategic (cum) operational framework; which the governing body puts in place to ensure the leadership of the organization makes appropriate decisions in an accountable manner. This include transparent and equitable stewardship of resources which will sustain the organization and keep it relevant to both the community in which it operate and the clients/customers it serves" (MacNamara, 2005). A Board Model in order to achieve the above therefore "represents an approach to the combination of the above elements" (MacNamara, 2005, 1).

2.1 Unitary and Two-Tier (Dual) Board Models

There is no fixed Board Model for all organizations. The Board as it has been stated is structured on organizational objectives. Any model chosen or advocated is not mutually exclusive of any other and may not totally fit the requirements of Board duty since good corporate governance entails much more than the choice and adoption of a particular model of corporate governance. The prevalent approach to board model in corporate governance is a fusion of different kinds of models in order to achieve organizational goals and good corporate governance.International Corporate Governance has however established two clearly discernible models: the Unitary Model; and the Two-Tier Model.

2.1.1 The Unitary Model

Commonly referred to as the Anglo-Saxon Model, the Unitary Board is composed of both executive and non-executive directors in a single board; hence, the term unitary. The non-executive directors usually outnumber the executive directors in a bid to serve as a balance and hold portfolio in the audit, remuneration and compensation committees. There is however some variance in the application of this system between the two dominant practitioners i.e. the United States, and the United Kingdom. In the UK, the CEO position is normally separated from the Chairman of the Board, and held by a separate person. In the U.S however, despite its publicly stated misgivings (Clarke, 2009), the practice of the fusion of the two roles is the norm where the CEO also serves as the Chairman of the Board. In those exceptional instances where the split of the two roles does occur in the US, it is seen as a transitional arrangement and a sign of weakness on the part of the Corporation. The irony is that even in the UK where the positions are split, executive directors were least unlikely to express policy disagreements with their CEO who in the US parlance had the ability "to make things happen".

The Unitary system represents the notion of widely held corporations controlled by their owners i.e. the shareholder Primacy Principle in Corporate Governance. Regardless of its shortcomings, the Unitary Board has its advantages: the assessment of risk is quicker and policies are more rapidly implemented; the challenges of convincing a panel of "ordinary" persons (as the Supervisor board is seen) by a panel of "experts" and its attendant friction is removed and Clarke is of the opinion that this is the dominant model in the future. Caution in the adoption of this model has however been succinctly given by benefit "in my service on the boards of nineteen public companies, however, I've seen how hard it is to replace a mediocre CEO if that person is also chairman. The deed usually gets done but almost very late." (Buffet, 2014)

2.1.2 The Two-Tier (Dual) Board Model

The Dual Board (as it is also known) is a means of improving corporate governance. Found in continental Europe including the Netherlands and Germany, it comprises of two Boards: the Executive Board i.e. company executives who run the company on a day to day basis; and the Supervisory Board made up entirely of non-executive directors who represent and are mostly from the rank of shareholders and employees having the power to dismiss members of the executive board, determine their compensation, and review major business decisions i.e. strategy.

This is the Stakeholder Primacy approach where industrial unions and other "outsiders" play a role in the running of the corporation. It is believed that the governance of a corporation involves all the parties who have an interest in the financial performance of the corporation: "Directors, Workers and Managers receive salaries, benefits and remuneration as employees (as the case may be), while investors expect to receive financial returns. For Lenders, it is specified interest payments, while returns to equity investors arise from dividend distributions or capital gains on their stock. Customers are concerned with the certainty of the provision of goods and services of an appropriate quality; suppliers are concerned with compensation for their goods and services and possible continued relationship". Thus, in order to protect all these interests, two boards exist side by side. The Supervisory Board in theory is to provide a monitoring role; a voice for those interested parties who cannot be part of the day to day running of the company in ensuring that the corporation is in sync with it, and their vision. It is however rather unfortunate that the performance of this role is fraught with hitches since the appointment of members to the supervisory board may not at all times be transparent, thus leading to inefficient monitoring and poor corporate governance (Monks and Minows, 2015).

There are certain characteristics distinguishing the two models from one another: the Two Tier system separates in a tangible way the direct management of a company and the function of supervising and overseeing the management function; it clearly defines the two functions of management and supervision, whilst ensuring that one person does not become befuddled with the two tasks; the two-tier system significantly diminishes the grandiose view of the traditional directors from the degree of liability that the serving Unitary board director is exposed to (Bacon and Brown, 1997:8).

These characteristics upon perusal have rightly led to the identification of three main differences between the Unitary, and Dual Board Models:

i. "The Unitary Board... remains in full control of every aspect of the Company's activities. It initiates action and it sees that the action which it has initiated is carried out. All its directors, whether executive or non-executive, share the same aims and the same responsibilities. The supervisory board on the other hand, may have to approve management action, but it is primarily a monitoring body, not an initiatory one. The task and duties of the two boards are different as are their legal responsibilities" (The Cadbury, Report, (1992).
ii. With the CEO being on a Unitary Board, the Board combines executive and non-executive directors whereas the supervisory board does not.
iii. The kind of people on the Unitary Board differs from those on the Supervisory Board. Apart from some of the Supervisory Board members having been appointed by the employees, a non-executive member of a Unitary Board may need a different set of requirements to being a member of a strictly supervisory body.

2.2 The Role of Culture in Board Models

The Board models are the direct tools for achievement of organization goals and good corporate governance. The choice is predicated on the vision that the founders have for the corporation. The vision is based on the convictions of the founders and their outlook as regards the business enterprise. This outlook is in turn as a result of the beliefs, values, knowledge, customs, norms etc, inherent in the locale where the founders, and the business, find themselves. This is culture. The board model adopted by an organization is therefore the direct result of the business orientation it has garnered from its cultural environment activities and values are the foundation of every country's culture and are the building blocks for developing business culture. Let us illustrate with four different countries and examines how the societal values have influenced their board models.

Germany

The German business culture is rooted in the adherence to prescribed business rules and allows for a low degree of flexibility and spontaneity in attitude and values. Surprises are most unwelcome even if such a surprise may improve the standing of the business. The security of work is sacrosanct, therefore the taking of risk by those in command of the organization is frowned at, since though it may lead to improving the profits of the corporation, it is also likely to be negative and lead to folding up. In safe guarding this tradition, there is the framework of regulatory conditions in the world of finance, on the one hand, and the structures of corporate governance and collective employee representation, on the other hand (Wever and Allen, 1993). The German business culture dictates the superiority of length of time of existence of a business (thereby ascertaining stability) over profit margin or growth rate.

The culture that work is sacrosanct results in the drive to reduce uncertainties that affect work, i.e. acts that could create a stoppage of work or create corporate failure which most likely comes from poor policies or jailed strategy (Homburg et al, 2009). All interested parties including workers must therefore have a part to play in ensuring that the corporation remains stable and a going concern. Hence the need to have industrial unions assumes a prominent role; and the adoption of the two-tier system where supervision of those saddled with the day to day running of affairs becomes imperative, on behalf of those that may be affected by their acts. The Corporation is seen as having a social contract with the society not just in terms of its doing business. Even before World War 1, legislation had been enacted in Germany that required all German public companies to report their result annually to shareholders and mandated close oversight by designated supervisory board of directors (Anfsichtract) (Fear and Khamna, 2003). By 1914 foreign investors found American regulation and its public accounting practices shoddy compared to the methods used in Germany.

China

The Chinese Society is a close knit environment where the State plays a role in almost all affairs of the citizens. As such it was a traditionally uptight business environment reflective of the strict conservative culture where even touching a person physically by patting on the back or a strong handshake could thwart the best of business proposal. Being socialist in political practice, the State protects the rights of workers by exercising control over Corporations thus inhibiting free market competition. In fact, the Chinese example is very illustrative of the role of culture in shaping board models and generally, corporate governance practices. The dictates of socialism impliedly stipulated the creation of socialist market oriented economy in order to improve and protect shareholders right, insulate companies' boards from inappropriate influences and reduce information asymmetry. The State exercised control directly over Companies. The Two-Tier board model was thus strictly employed.

With the internationalization of trade and it vast market, China accessed the World Trade Organization on the 11th December, 2001. This accession came with international competition which meant a reform of the erstwhile laws in order to compete favorably in the new dispensation. The problem was how to embrace the liberalization mantra of World trade, and retain the socialist culture of business and corporate governance.
In order to satisfy the WTO standard, and at the same time preserve its cultural business orientation of protection of shareholders right (in any event, the State on behalf of the people were still the largest shareholders), China reformed its corporate governance principle by promulgating; the Company Law in 1993 (revised in 2005); The Securities Law in 1998 (revised in 2005); and the Code of Corporate Governance for Listed Companies in China (CSRC and ETC 2002). To eliminate the dominant managerial powers of the Board of Directors in the newly listed companies consequent upon the reforms, the Chinese Securities Regulatory Commission (CSRC) in 2001 issued "The Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies (Round, 2012).

China came up with its own variant of the Dual Board by having three tiers of control:

- The shareholders meeting, known as "the organ of power of the corporation". It is the supreme power in corporate governance. By Law, Shareholders have the power to call meetings, elect and replace directors and supervisors, and approve their report. This is coupled with the right to examine corporate startegy.
- The board of directors, which also have the same extent of managerial powers as contemplated by the reforms and acts as the critical link between ownership and corporate governance.
- The supervisory board, saddled majorly with the task of overseeing the board of directors.

The regulations themselves shows the impact that the Chinese culture of business had on them, and the resultant board model adopted was to maintain the socialist culture of protection of workers right through state intervention.

The United States and the United Kingdom

The Anglo-American business culture is capitalist in nature. This means that the corporation has a fundamental allegiance towards its business interests and not to the society except as a way of further propagating its business goodwill and or image through the doctrine of corporate social responsibility. In this regard, growth of the company is largely synonymous with success of the Company and its management team. The success per se is not in stability of the organization or in a steady marginal growth but rather in the rapidity of out maneuvering the competition. Given the nature, there is no room for slackness and decisions as to corporate strategy in form of risks are to be taken without undue bureaucratic red tape. The person responsible for projecting the objectives of the Corporation is the CEO and his leadership qualities are extolled and celebrated in business bookshops in the way reserved for Statesmen, Generals and Explorers (Clarke, 2009).

Into this business environment the only board model fitting is the Unitary Board. The cultural orientation of the business environment does not admit of a supervisor for the supervisor. In fact, in the rare cases where there is a split in the position of CEO and Chairman of the Board, it is seen as the transitional arrangement temporarily put in place to correct an inherent weakness of the company. The dominance of the CEO over the affairs of the Corporation is so enshrined that Westphal and Khanna's survey of Forbes 500 companies in the US revealed the propensity for non-executive directors to experience social sanctions if they are perceived as threatening the elite position (of CEO) by advocating,
-the separation/split of the position of CEO and Chairman
-the creation of independent nominating committees (as a check on the CEO's power to do so)
-the dismissal of the CEO (Westphal and Khanna, 2003)

In the UK, there is also a similar situation as Clarke has rightly stated, though there is the clear refusal to fuse the position of powers (UK Compined Code, 2010).

Nigeria

Corporate governance in Nigeria has been characterized by the dominant ideological belief attendant upon the post-colonial period i.e. economic self-dependence. This meant indigenous ownership and control of resources or means of production at the public level; and individual exclusive ownership of companies at the private level. The government imposed total and absolute control over public utilities, infrastructure and social service provision with the establishment of state owned Corporations. Interest of investors was turned down with the prohibition of foreign ownership. Legislations to this effect were put in place (Ahunwan, 2002). This meant that the State being the dominant force scooped up the ownership of major companies and in a seeming show of liberalization divested shares to a few wealthy people who had close ties to government. The business environment has since then witnessed a predominant tendency to hold ownership of Corporations as sacred by the initial owners and the tendency to engage in any acts to do so.

The culture reflects a winner takes all attitude, and a Machiavellian streak in the average Nigerian businessman. This cannot accommodate the strict external supervision inherent in the Dual Board model, hence the business culture in Nigeria is to have a Unitary Board.

2.3 The OECD Principle and Board Models

The OECD Principles of Corporate Governance 2004 represent the most concise attempt so far in formulating guidance for the attainment of good corporate governance. Whilst not being laws, they serve as the standards of corporate governance in contemporary global corporate practice. Along with the other such guidelines (The Cadbury Report, UK. 1992) (The Sarbannes Oxley Act, 2002), they serve as the general principles around which businesses are expected to operate to assure proper governance.

Divided into six sections, it provides for the following:

- Ensuring the basis for an effective Corporate Governance framework
- The rights of the shareholders and key ownership functions
- The equitable treatment of shareholders
- The role of stakeholders in Corporate Governance
- Disclosure and Transparency
- The responsibilities of the Board

It is the considered opinion, from the wordings of the provision that the OECD aligns with the Shareholders Primacy Principle in Corporate Governance despite its carefully worded seemingly all-embracing provisions. It clearly promotes the Unitary Board Model by emphasizing on the Shareholder rather than the Stakeholder. To circumvent this seeming preference however it states (The OECD Principle, 2004) “there is no single model of good corporate governance. However, work carried out in both OECD and non-OECD countries and within the organization has identified some common elements that underlie good corporate governance... For example, they do not advocate any particular board structure and the term ‘board’ as used in this document is meant to embrace the different national models of board structures found in OECD and non-OECD countries.” A further of the principle also leads to a Shareholder Primacy conclusion. The provisions of Section IV is as to the role of stakeholders and the respect of their rights “where” they have been created by law or through mutual agreement which signifies that they may not have been created in some instances.

3. CRITICAL ASSESSMENT OF CULTURE, BOARD MODELS AND OECD PRINCIPLES IN CORPORATE GOVERNANCE.

There is no gainsaying the fact that the OECD has established a basis for the practice of good corporate governance. It has as much as possible tried to formulate and develop good practices in corporate governance matters which the company law conveniently laid at the doorsteps of 'managers' of businesses. The global developments in international commerce required that any such principle(s) must have a truly international appeal, hence the attempt to make the principles an omnibus guide. The major responsibilities enshrined in the principle and indeed all other codes are imposed on the Board of Corporations as the brain of the corporate entity.

Thus there is a tendency to feel or think that it is the dictates of the code/principles that bring forth the kind or type of board that a corporation adopts. This is not so. The corporation is brought through the implementation of a mindset, a plan, a vision nurtured over the years by knowledge acquired from societal values, norms, customs and teaching. It is unlikely that a person who greets the Saudi Prince in the ways of Christianity will get a job in the palace; nor the Prince himself at the Vatican, no matter how impressive the resume is. The study of the business orientations and operations of those countries earlier seen has shown that their organizational decisions are inherently borne out of cultural affinities and to a large extent, nothing more.

The OECD itself, and indeed the other Codes stated herein are primarily based on cultural values. The unfettered right to structure a business in a manner most amenable to the owners is guaranteed. Sir Adrian Cadbury's report was regarded as highly controversial at the time because it dared attempt to specify the 'doing of business' though at the time it represented no more than reasonable best practice, leading him to state that there was no such thing as "one size fits all" and that it was not an attempt to regulate the conduct of business but a guide. A Chinese business deal of the highest order may likely fail because the American Investor attempted some humor to create a more conducive atmosphere, but was believed by his Hosts to be insulting. The hug which signifies a compliment at a business meeting in Mexico, is wholly prohibited in Beijing (Bowie, 2008).

The business culture of the US charges the board of directors with representing shareholders rights; a task given to the supervisory board in Germany (Dennis and McConnell, 2003). To harmonize the Company Law in the European Union has met a solid brick-wall: countries do not want elements of their own systems of Corporate Governance disappear by being subsumed under an external legislation. Culture influences legislation, once legislation is gone, the cultural underpinnings of the Law also disappears. For Corporate Governance to fully assume its status, more emphasis need to be placed on Culture and its values, and how it shapes the models of boards adopted in each society to superintended business. It is only then a truly international corporate governance code can be brought to fore. As Reberioux (2000) has said "the diversity of corporate models is valuable and is rooted in societal characteristics that together shape the competitiveness of the different models… (Reberioux, 2000).

4. CONCLUSION

This paper examined the role and relevance of culture in shaping the outlook of a board of directors of a Corporation or its equivalent, as the case may be. Using different systems as a yardstick of measure, the integral part that culture plays in the choice of a board in corporate operations is brought to fore. The OECD Principles were examined as to their stipulations for an ideal Board and its purposes, and then juxtaposed with the effect and influence of the choice of a board model by Culture. It is then clear that to a very large extent, culture, and cultural values and affiliations play a major role in selection of board models.

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