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The increasing cost of corporate governance: decision speed-bumps for managers

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Abstract

Purpose – *Decision speed, flexibility, and innovation have often been cited as key ingredients to business success on the turbulent twenty-first century business landscape. Sets out to argue that the increasing emphasis on legal and regulatory compliance, the push for which can be attributed to the spectacular collapses of WorldCom and Enron, will burden management with decision-making speed-bumps as opposed to protecting shareholders' interests.*

Design/methodology/approach – *The impact of legal and regulatory compliance is discussed within the business decision-making context. Businesses succeed or fail in a dynamic environment where the smallest advantage can push one competitor ahead of another. Arguments in favour of increasing legal compliance are debated and the impacts of proposed regulatory compliance issues are discussed within the context of the competing business firm and its need for speed and flexibility.*

Findings – *The issue of increasing and stricter compliance for business is far-reaching. Attempting to protect shareholder interests through further measures of compliance will only introduce further operating complexities for management while increasing costs and reducing decision speeds and flexibility. The impact on firms forced to compete under such conditions will be considerable, particularly if they find themselves on an international landscape competing against firms not burdened with the same regulatory requirements.*

Originality/value – *This paper is based on original work by the authors commencing with issues surrounding shareholders versus stakeholders, followed by a debate concerning corporate governance mechanisms and a discussion concerning the consequences and impacts of levying further regulatory burdens on business and managers.*

Keywords *Contracts, Controls, Corporate governance*
Paper type *Case study*

Introduction

Much of the recent interest in the field of corporate governance has been driven by corporate scandals in the USA, involving firms such as Enron and WorldCom. This has been highlighted by the OECD: "Recent corporate scandals have focused the minds of governments, regulators, companies, investors and the general public on weaknesses in corporate governance systems and the need to address this issue" (OECD, 2004, p. 1). As a result governments and financial market regulatory bodies have proposed or put in place various changes relating to directors' responsibilities, the role of independent directors, new and/or more stringent external reporting requirements and minimum disclosure levels. A dominant focus of the changes is on strengthening the role and function of the board. The overall goal is an attempt to significantly lessen opportunities for corporate mismanagement and instances of corporate collapse and thereby provide better protection for shareholders and other business stakeholders.

In this paper we argue that the various governance changes implemented and proposed may have unforeseen negative consequences, even though they may ostensibly achieve their intended goal of better corporate governance. From an internal business perspective

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we suggest that an increased regulatory focus on corporate governance has the potential to significantly hinder and restrict senior management in their role. This relates to their scope and ability to successfully manage an organisation in relation to what may be an increasingly unpredictable, turbulent and capricious external environment. A key challenge relating to recent corporate governance rule changes is that they have "grown in *volume* and *complexity* as we have attempted to turn an art into a science. In the process, we have fostered a *technical, legalistic* mindset that is sometimes more concerned with form rather than the substance of what is reported" (emphasis added) (Bartholomeusz, 2002, p. 591). In other words, corporate governance requirements arguably have the potential of being pervasive to the degree that they distract and hinder management in their core task of creating long-term value for the business. Managers may, for example, become pre-occupied with governance requirements and hesitant about taking calculated risks in relation to the running of the business for fear of contravening governance guidelines and rules. A key thrust of recent corporate governance change "is the creation of an independent board to *monitor management closely*" (emphasis added) (Grantham, 2004, p. 218). However, close monitoring could be overly intrusive and place pressure on managers in terms of limiting their freedom and discretion in relation to the management and operation of an organisation. We suggest that a balance needs to be achieved between attaining satisfactory levels of shareholder and stakeholder protection versus allowing and supporting a management approach that is highly responsive and agile in relation to the external business landscape. Not attainting a suitable balance means that the role of senior management in public corporations is likely to become more difficult.

The remainder of this paper is organised as follows. Section one outlines the conventional shareholder and stakeholder approaches to corporate governance and discusses how these appear to be converging and becoming less distinct, due to an increasing regulatory focus. Section two outlines the mechanisms traditionally used to achieve corporate governance, while section three discusses the increasing use of regulatory and legal mechanisms and highlights the potential problems associated with this approach. In section four the effect on corporate governance of the form and structure of contemporary organisations is discussed. Section five proposes some potential solutions in relation to a more balanced approach to corporate governance in order to help deal with environmental turbulence. Finally, section six contains a summary and conclusions.

1. Shareholders versus stakeholders

The scope of corporate governance in the literature involves two main approaches. The first is the more traditional view that derives from agency theory and the problems associated with the separation of ownership and control. This is about ensuring that management undertake their role for the benefit of shareholders. On this view "corporate governance is fundamentally about management's incentives to act in shareholders' interests" (Denis, 2001, p. 201). This approach tends to be associated with a contractarian position on corporate governance, which has been dominant in Anglo-American countries (Denis, 2001). Historically, this has been seen as "more conducive to the need for adaptation to a rapidly changing world" (Denis, 2001, p. 209). A Contractarian position has generally been considered flexible and effective: "Rather than advocate the imposition of legal constraints on the behaviour of corporate managers, (the contractarian approach relies) on voluntary contracting and market forces to align the interests of managers and stockholders" (Bradley *et al.*, 1999).

The other main approach to corporate governance involves a broader focus on managing the relationships among various stakeholders rather than just protecting the interests of shareholders. This reflects a communitarian position, which is generally associated with countries such as Germany and Japan, where employees and suppliers have an integral role in the governance of firms (Lashgari, 2004). The OECD, for example, endorses such a position: "If the enterprise is to be successful, the board will also have to consider stakeholders such as employees and creditors who supply the firm with resources and who also need access to timely and relevant information" (OECD, 2004, p. 3). This reflects the idea of a "socially responsible corporation" which is seen as having interests that extend beyond the traditional realm of shareholders. This approach views an organisation as a

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separate entity with rights and responsibilities the same as a natural person: "Communitarians believe that corporate managers have a social responsibility not only to the shareholders, but to all of the firm's stakeholders" (Bradley *et al.*, 1999, p. 44). In this context it is considered necessary to put in place legal constraints to ensure that managers are accountable to both shareholders and stakeholders. This approach requires a greater focus on regulations and rules governing the operation of the organisation.

The communitarian and contractarian approaches appear to be moving closer together (Holmstrom and Kaplan, 2001). This is particularly evident as a result of the increasingly stringent corporate governance regulatory framework. From a legal or regulatory position, contractarians view law "as a means of ensuring *ex ante* freedom and efficiency of contracting, while communitarians see law as a vehicle to ensure distributive justice and equity from the payoffs to contracts" (Bradley *et al.*, 1999, p. 45). The field of corporate governance, however, is being ever more subjected to a regulated and structured approach. From a contractarian position, higher levels of regulation are recognition that voluntary contracting between parties and the associated protection of shareholder interests is important, requires further strengthening and needs to operate within clear legal parameters. However, this is weakening the traditional contractarian approach where governance is seen as a private matter between shareholders and managers. Greater regulation is also providing scope for an increased emphasis on protecting stakeholders (rather than solely shareholders), which reflects a communitarian position. Overall, increasing levels of externally imposed regulation is leading to a convergence between the contractarian and communitarian positions and a blurring of the distinction between the two. The contemporary governance approach is increasingly dictated by government imposed and/or sanctioned regulation and is prescriptive in focus. The motivation for such change is based on a perceived need for more rigorous protection of both shareholders and stakeholders, rather than any conceptual basis in either contractarianism or communitarianism. The various mechanisms that have been used to execute corporate governance are considered in the following section.

2. Corporate governance mechanisms

Following Jensen (1993) and Denis (2001), corporate governance has historically been achieved using a mix of four mechanisms:

1. legal and regulatory;
2. internal control;
3. external control (capital markets); and
4. product and market competition.

Legal and regulatory mechanisms are externally imposed on organisations and encompass rules and regulations put in place by governments, stock exchanges and other regulatory bodies. Internal control, which is also subject to external regulation, is largely concerned with board decisions about the size, composition and function of the board of directors. In general it is suggested that smaller boards are best (about seven or eight members) and that the majority of directors should be independent (Denis, 2001). Legal and regulatory and internal control mechanisms have more and more been the focus of governments and regulatory bodies as a response to the corporate scandals and collapses of recent years. In this sense these mechanisms highlight the increasing rule-based approach to corporate governance and the convergence of the communitarian and contractarian positions.

External control occurs via outsiders acquiring large blocks of shares and imposing a more disciplined approach to firm operations and corporate governance procedures. In this way non-executive owners can exert a high degree of external (and also internal) control by closely scrutinising the actions of senior management. Product market competition reflects that at the extreme, poor corporate governance may lead to business failure due to some combination of inefficient cost structures and a product and/or service mix not meeting market needs. As a result an organisation may suffer low profitability or losses. Product market competition is perhaps potentially more effective today than in the past due to the

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impact of globalisation and relatively low or non-existent tariffs on the import/export of many manufactured goods and services. Therefore in the current business environment few firms have the luxury of serving a local protected marketplace. External control and product market competition are strongly free-market orientated in their operation. Reliance on these mechanisms is based on a firm belief that the disciplines of the market-place can achieve effective corporate governance. Of themselves, however, these are arguably relatively weak and reactive (rather than proactive) tools of corporate governance.

The prime thrust of corporate governance is increasingly in terms of legal and regulatory and internal control mechanisms. Reliance on external control and competitive markets is seen as more risky and problematic due to its generally lagging and reactive nature. The aim of legal and regulatory and internal control mechanisms is a more proactive approach to corporate governance. The following section illustrates further how corporate governance is increasingly focused on legal and regulatory compliance and internal control.

3. The regulation of corporate governance

Throughout the world various legal and regulatory changes have been proposed or implemented in an attempt to improve corporate governance. Legal commentators in particular have advocated a greater role for legislation and government sanctioned regulatory bodies in the operation of corporate governance: "The challenge at a moment such as this is to understand which aspects of corporate governance can be strengthened by a *regulatory* or *legislative* approach, which necessarily focuses on form and disclosure" (emphasis added) (Segal, 2002, p. 320). In the USA important changes are contained within the Sarbanes-Oxley Act (SOA) and the proposals of the New York Stock Exchange. In terms of the SOA, there is a rush to comply with Section 404, which is an attempt to force organisations to adopt better corporate governance practices. But this requires very careful documentation of accounting and other processes which is creating pressures and demands in terms of data storage and technology upgrades. In the UK various recommendations are contained within the Higgs and Smith reports. The Australian Stock Exchange Corporate Governance Council has issued a set of Principles of Good Corporate Governance and Best Practice Recommendations that they suggest members should adopt unless they provide clear reasons for not adopting. Plus the Australian federal government has enacted the Corporate Law Economic Reform Program Act 2004. The overall emphasis of all these changes is on greater shareholder protection, financial reporting reform, continuous disclosure, audit reform, auditor independence and enforcement. Changes proposed within or required by these various reports and regulations include (Bosch, 2002; Mallesons Stephen Jaques, 2003):

- a majority of independent board members;
- the adoption of formal board charters, setting out in detail functions that the board is expected to perform;
- board code of conduct policy manual, relating to the operation of meetings and the conduct of directors;
- detailed directors' manuals;
- systematic reviews by the board of internal control systems, risk analysis and compliance with a wide range of company policies;
- board chair to be an independent director;
- public disclosure of CEO remuneration policies and actual remuneration paid;
- CEO and CFO to formally and personally sign-off on the financial reports;
- formation of formal and independent audit and remuneration committees;
- formal reviews of board performance;
- nomination committees for board appointees; and
- detailed job specifications for new board appointees.

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Essentially these regulatory proposals reflect a strong prescriptive approach to corporate governance, in terms of attempting to tightly specify the role and responsibilities of the board and how these should be discharged. Such proposals could, though, effectively also limit the scope of management. This is exemplified by the US situation, where governance issues have historically been a private matter between shareholders and managers (i.e. the traditional contractarian approach). However, the passing of the SOA has made structures relating to corporate governance the subject of federal legal compliance. This has placed US corporations under increased scrutiny and imposed increased costs via the time required to validate the internal control function, plus associated software and data storage costs. The SOA places an additional layer of compliance and regulation on US corporations. An important part of the SOA involves processes relating to the registration of auditors, audit committees and their function. The requirements for these aspects are relatively detailed and prescriptive (Segal, 2002). The SOA has also instituted fundamental reform of the reporting of corporate financial information. In this paper we argue that such changes have the potential to distract the board from their role of corporate and management oversight and lead to a more directive and interfering approach concerning traditional management responsibilities and tasks. In other words, the changes create incentives for boards to become more actively involved in the customary tasks and decisions of senior management.

Compliance focus

An increasing focus on compliance and regulation has the potential to distract both the board and management from their key responsibilities. A likely outcome is that because boards become more preoccupied with compliance, senior management in turn will become more involved with this task: "in many companies a considerable amount of board time is spent on compliance with law rather than company performance" (Bosch, 2002, p. 276). A key thrust of corporate governance change is to make "management more accountable to boards and making boards more accountable to shareholders" (Bosch, 2002, p. 277). In doing so this may effectively restrict the scope of management to manage the business effectively in response to a turbulent and dynamic external environment.

While the stated intention of corporate governance change is not to over regulate or heavily prescribe, the actual substance of the changes proposed and implemented means that this is difficult to avoid. The move to regulate is premised on the view that corporate governance is generally too weak and in need of tighter definition and control. For example, in a US context it has been argued that government-based "regulatory agencies must undertake a comprehensive corporate and markets governance reform that eliminates – to every extent possible – the existence of conflicts of interest and establishes a *control framework* permitting the timely discovery and prompt sanction of any ethical deviations by market participants" (emphasis added) (Guerra, 2004). While such edicts may appear relatively non-controversial, in practice they may be problematic. This is because control frameworks by their nature are designed to restrict and limit management discretion and decision scope (e.g. see Otley *et al.*, 1995; Otley, 2001). While control and regulatory frameworks may be functional from a purely legal or technical viewpoint, their operational impact on managers working in dynamic and rapidly-changing business environments may be problematic.

The role of corporate governance could also become esoteric and more complex via the addition of further compliance layers to the governance framework. For example, from a legal perspective it has been proposed that:

> ... organisational and individual [corporate] governance responsibilities integrate politico-regulatory, financial, socioeconomic and environmental concerns in a holistic way which flows through to strategic planning, performance and corporate outcomes ... corporate governance should be moving from "single bottom line" and "triple bottom line" frameworks to "quadruple bottom line" thinking (Horrigan, 2002, p. 524).

The idea of a quadruple bottom line "focuses on the dynamic interaction between components which cover financial, socioeconomic, and environmental concerns, as well as governance and regulatory concerns" (Horrigan, 2002, p. 518). Additional externally imposed changes such as these illustrate how the regulatory thrust of corporate governance

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could become even more pronounced, leading to further compliance responsibilities being placed on management and directors.

The overall goal of business and economic regulation, including corporate governance, is to improve market efficiency (Guasch and Hahn, 1999). This should enhance the operation of markets and facilitate the flow of capital between firms (Jensen, 1993). Therefore some level of corporate governance regulation is a necessary component of a well functioning economy. In countries that lack effective or well-developed economic regulatory frameworks, including systems of corporate governance, economic performance is likely to be impeded (Guasch and Hahn, 1999). Accordingly, the implementation of regulatory and governance frameworks in such countries is likely to be beneficial. For example, Hanousek and Kocenda (2003) provide evidence that in the Czech Republic, which is being transformed into a market-based economy, improvements in corporate governance resulted in improvements in the profitability of mass-privatised businesses. However, there is uncertainty concerning the benefits of imposing ever higher and more prescriptive levels of corporate governance regulation. This is because "overregulation can be quite as dangerous as underregulation. Indeed, overregulation or poor regulation can undermine a firm's or an industry's ability to do the very thing that regulation is trying to encourage" (Jackman, 2004). Arguably, this is a key risk with the growing focus on prescriptive corporate governance regulation and compliance. As a result the role of management to manage may be impeded, which may negatively impact firm performance and the operation of a competitive marketplace. In this context it has been estimated that excessive regulation may negatively impact GDP (e.g. Koedijk and Kremers, 1996; Guasch and Hahn, 1999) and reduce firm innovation and productivity (Winston, 1998). Other research has demonstrated that increased regulation may impose significant costs on firms and that its benefits can be uncertain. In relation to increased regulation of the US banking industry, for example, Elliehausen and Lowrey (2000) empirically investigated the costs of implementing frequent banking regulatory changes and concluded that this may impose non-negligible costs on banks. In the context of corporate governance, Weir and Laing (2000) and Laing and Weir (1999) investigated the extent to which corporate governance changes recommended by the UK Cadbury Committee in 1992 had affected the performance of firms that had adopted the changes. They found only mixed evidence that the changes were associated with better firm performance: "Complete compliance with the model of governance proposed by the Cadbury Committee does not, however, appear, to be associated with performance which is better than firms that achieved either partial or non compliance" (Weir and Laing, 2000, p. 265). In contrast to a compliance focus on regulatory change, research by Verschoor (1998) into an emphasis on ethics as an aspect of corporate governance found "a statistically significant linkage between a management commitment to strong controls that emphasize ethical and socially responsible *behavior* on the one hand and favourable financial performance on the other" (emphasises added) (Verschoor, 1998, p. 1515). This result highlights the importance of encouraging and supporting appropriate firm behaviour as a means of helping to ensure good corporate governance. Conversely, imposing increasing levels of prescriptive change and/or adopting a strong compliance or "check-the-box" focus may be less likely to have a positive effect on firm performance.

The role of directors

A key thrust of corporate governance change is to strengthen the role of directors generally and non-executive directors in particular. This would be accomplished via larger boards comprised of greater numbers of independent directors. The aim of such change would be to facilitate better checks and balances on the activities of senior management. It also means, however, that non-executive directors could become more intrusive in terms of their oversight of management activities, which could lead to a more adversarial and less cohesive boardroom situation.

Greater numbers of independent directors may mean that the board overall is likely to have only minimal or limited knowledge about the business or its industry (Hilmer and Donaldson, 1996). Requiring a majority of independent board members may be of questionable value because such persons may be less familiar with the business and its operations. Conversely,

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non-independent directors should have more in-depth knowledge of an organisation and may be able to more effectively challenge and question management concerning their decisions and actions. It has also been argued that the likelihood of finding truly "independent" directors is low (Grantham, 2004; McConvill and Bagaric, 2004). Therefore attempting to regulate higher levels of corporate governance may be to some degree illusionary and will simply serve to distract managers from their role.

A further factor explaining the greater emphasis on corporate governance is public outrage at the largess of some CEO salary packages. In this context an underlying thrust of recent legal and regulatory changes is that a majority of independent or outside directors should help to limit such excesses. Historically though, it has been suggested that insider dominated boards have not necessarily been associated with excessive CEO salaries: "In earlier years, when inside dominated boards were commonplace, the compensation of CEOs was less dramatically large and closer to that of other members of management" (Weidenbaum, 2004, p. 151). This implies that stipulating a majority of independent (outside) directors may not necessarily limit the size of CEO compensation packages. Moreover, research to date "fail[s] to find that outsider-dominated boards are associated with more profitable companies" (Hilmer and Donaldson, 1996).

4. The form and structure of contemporary organisations

Large public corporations operate in a constantly changing and evolving business environment. This is increasingly globalised, difficult to predict or forecast within, subject to rapid technological change and innovation and increasingly populated with new organisational forms and structures (Jensen, 1993; Quinn, 2002). Organisations operating within such an environment are increasingly recognised and defined less in terms physical assets and location and more in terms of key personnel, intellectual capital, innovation and branding (Barkema *et al.*, 2002). These are aspects for which the concept of ownership is often nebulous and more difficult to establish.

Corporate governance traditionally has been based on either the concept of agency theory and the need to ensure that managers work in the best interests of shareholders, or the broader idea of accountability to stakeholders. Arguably these approaches fit best in an environment where labour and the skill it provides is seen simply as a factor of production that can be readily controlled. Governance becomes more difficult if labour is instead more a source of innovative ideas and intellectual capital, over which the business has no direct ownership rights or control. Organisations operating in such an environment may find that the control of business activity becomes more difficult. In this context, if organisations "can neither measure a subordinate's work with reliable validity nor specify the steps to accomplish the desired outcomes, then process-and output-orientated control systems imported from the days of the Industrial Revolution will be suboptimal, if not a counter-productive failure" (Bradley *et al.*, 1999, p. 30).

The various corporate governance regulations and controls that have been proposed and implemented would arguably operate best in large vertically integrated businesses with clearly defined outputs and geographical boundaries. Their operation is arguably less certain in highly networked or relatively flat businesses with extensive global interests and operations, where traditional notions of hierarchical control are likely to be less effective. The changing nature of contemporary business is likely to complicate the effectiveness of regulatory- and legal-based corporate governance. If ownership is unclear or less certain then a strong control and compliance approach to corporate governance may lack effectiveness in a significant number of organisations. Following this view, the underlying thrust of corporate governance should instead be on the management and motivation of human capital: "The growing prominence of corporations where physical assets are unimportant relative to human assets raises a number of new issues of governance. Where do outsiders get authority from, especially because human capital is not ownable?" (Rajan and Zingales, 2000, p. 19).

The changing business environment means that the efficacy of a traditional corporate governance approach could be questioned. Managers cannot be instructed or compelled to

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act totally in the interests of shareholders via some form of contractual control system or external regulation. No form of contractual control or regulation can capture or foresee all circumstances relating to the operation of many contemporary corporations. In this sense a corporate governance approach that is increasingly one of a regulatory compliance is likely to be suboptimal in relation to longer-term business performance. As a result in some public corporations it may be more important for corporate governance to be focused to a greater degree on organisational design issues rather than prescriptive control and compliance. This means structures and processes that underpin and provide effective governance, but at the same time do not limit or distract management from responding to a dynamic and capricious external environment, would need to be devised. In other words, corporate governance systems should allow managers scope for flexibility and to make rapid change in relation to how they perceive the external environment and their management of ongoing operations.

5. Potential solutions

The claim could be made that regardless of the degree of regulatory compliance imposed, those who intend to defraud or mismanage will do so. Thucydides once made the claim in the fifth century BC that "it is in the very nature of humans to act in the future as they did in the past" (Thucydides, 1966). How would this happen in business? Rules can be broken. In the case of Enron, Vinten (2002) points out that many of Enron's most significant transactions were designed to achieve favourable financial statement results rather than achieve bona fide economic objectives or facilitate the transfer of risk, and Enron manipulated the composition of its audit team by removing Carl Bass who was unhappy with aspects of Enron's operations, thereby successfully hiding debt and losses. Vinten (2002, p. 5) points out that in almost all the transactions there was extensive advice and participation from Andersen. Vinen (1993) relates a similar occurrence in the late 1980s when troubled Bond Corporation in Australia sacked Price Waterhouse as auditor after a dispute and then hired Arthur Andersen for their 1988 audit. Vinen (1993) suggests that Andersen did not carry out their role with the necessary care and diligence required of an auditor. The subsequent collapse of Bond Corporation should not have been a surprise to anyone if the auditors had done their work.

These examples highlight the inherent weaknesses that exist within a legal and regulatory framework; they can be manipulated and exploited regardless of their apparent comprehensive nature. As another example, consider the unfolding of events at WorldCom, described retrospectively by Boyd (2003) as a company without substance or soul. Can tougher regulations really deter corporate failures of this magnitude? Can tougher regulations prevent a determined team from achieving their nefarious goals? Can tougher regulations act as a deterrent when unscrupulous managers are intent on hiding their greed-based activities? The determined and cunning will succeed – at least until their activities are accidentally revealed or they have cannibalised the corporation to such an extent that it can no longer function (see Pech and Durden, 2004).

Regulations and laws are necessary, largely to remove temptation and to facilitate the governing of business in a transparent and law abiding manner. The bad behaviours of a few should not, however, be allowed to result in the placement of what appears to be an ever-increasing burden of restrictions and compliance costs on the greater majority of law-abiding business managers.

The discussion thus far has suggested three possible propositions to resolve the difficulties that we predict will be associated with an increasingly regulatory and legal-based governance landscape:

1. Focus on management and motivation rather than increasing regulations and a further plethora of prescriptive control mechanisms.
2. Focus on organisational design rather than inflicting generic and costly templated compliance measures upon already burdened business entities.
3. Focus on flexibility rather than further complicating an already convoluted and bureaucratically debilitating business decision process.

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Management and motivation

Reforms that facilitate transparency within management and strategic decision processes should be a high priority. Transparency will reduce the possibility of cover-ups, illegal activities, and incompetence, and it will expose the motivations of decision-makers where those motivations are derived out of selfish greed rather than the greater corporate good.

Organisational design

Increasing the number of regulations, increasing the number of board members, increasing the number of independent board members, all of these imposed changes will increase business operating costs and increase resource attrition. Decisions will be delayed, meetings will be held more often, they will be lengthy and they will be indecisive. Pech and Slade (2003) make a comparison between business and warfare and argue "A competitor's historical advantage and currently deployable assets are no longer predictors for success. Success now rests with the decision maker's ability to out-think and out-manoeuvre an opponent whilst utilising two important decision criteria – speed and economy of effort" (Pech and Slade, 2003, p. 886). The great fear is that corporations will be forced to work within the limitations imposed by restrictive, confining, ill-informed, and rule-laden boardrooms and decision templates that make their activities patterned and predictive. This would be analogous to a return to the trenches of WWI and the costly attrition rates of rusty mechanised competition. A competitor not burdened with the same regulatory frameworks and subsequent handicaps will completely out-manoeuvre the slower, over-regulated business firms. Pech and Slade (2003, p. 890) conclude by arguing that economy of effort and an action orientation facilitate decision process effectiveness.

When an organisation is designed for competition, it becomes sleek, responsive, cost-effective, and market oriented. At its most destructive, an organisation that focuses on restrictive regulatory compliance ahead of its position in the market will value and reward managerialism and bureaucratic protocols. It will lack the ability to sustain a competitive edge over its less burdened rivals, it will decline in value and its subsequent demise will increase capital market volatility. This is not the outcome that stricter corporate governance legislation is looking for, but it may be the consequence of such measures if they become binding on the corporate decision makers.

Focus on flexibility

Loss of flexibility is a major prohibitive consequence of introducing stricter corporate governance laws. Flexibility is viewed as a key success factor when competing on a dynamic and hostile landscape. Which business entity can say with certainty that their position in the market is secure? The ongoing changes in the order and composition of the world's top companies are a testament to the volatile landscapes on which they compete. It is speculated that a firm that focuses on maintaining flexibility as a strategic performance enabler will not have the will, the energy, or the resources to construct false edifices around mismanaged or fraudulent activities.

6. Summary and conclusions

The role of professional managers and the tasks they undertake in what is increasingly a turbulent and capricious external environment seem to have been neglected in the current regulatory focus on corporate governance. We argue that in some organisations there is a risk that an ever more prescriptive, legal and regulatory approach to corporate governance may stifle management in terms of an agile and rapid response to external pressures. This position is reinforced by literature highlighting the potential costs associated with excessive levels of regulation (e.g. Koedijk and Kremers, 1996; Guasch and Hahn, 1999). Regulatory obstacles will create decision speed bumps, diverting and diluting management efforts. As a result competitive strategies, business flexibility, and efforts to adapt to changing environmental circumstances will become less important for managers. Instead management will be required to concentrate on politicking, the management of shareholders and directors, and regulatory compliance. It is argued that this shift in focus

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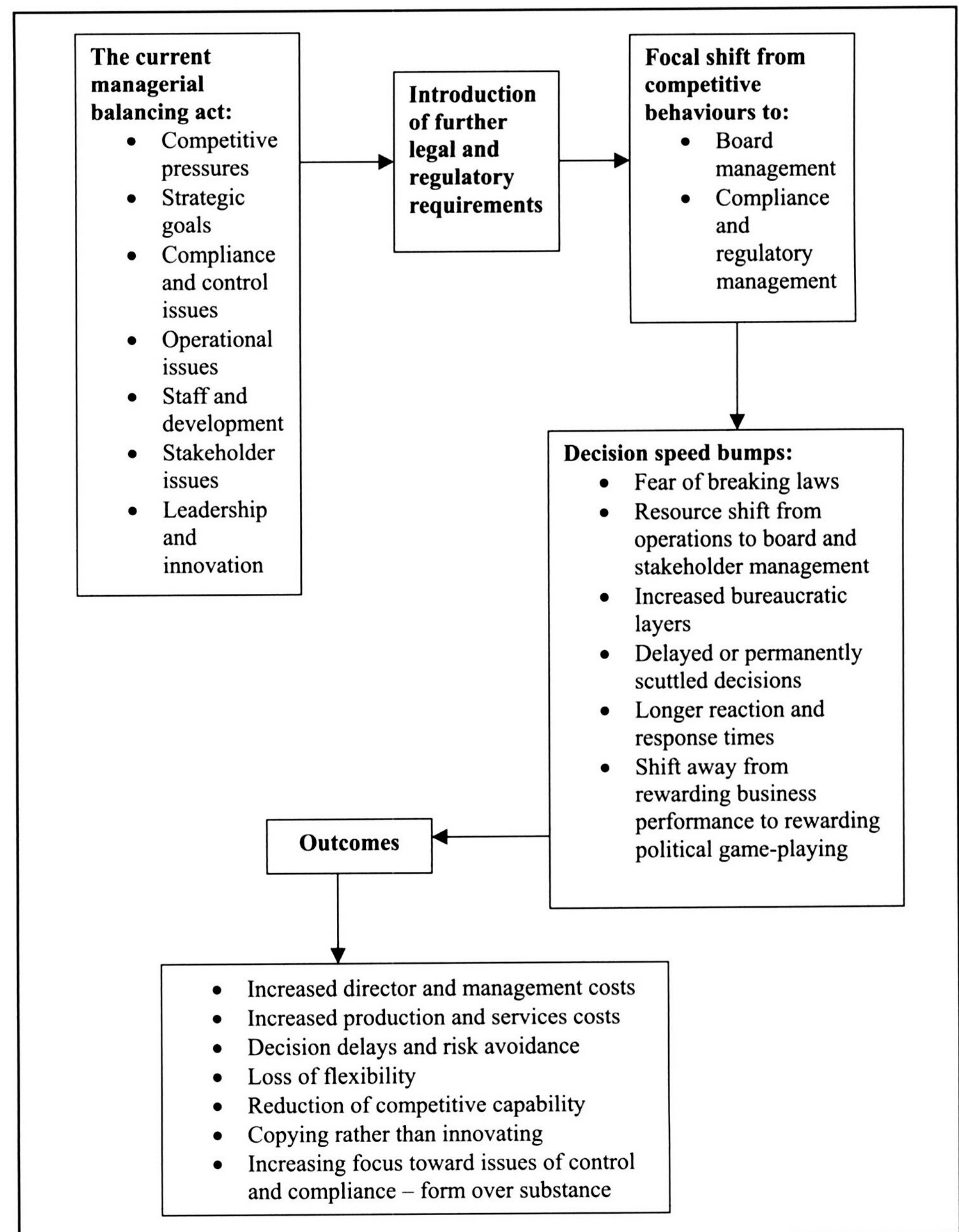
will be particularly harmful to firms operating in rapidly changing and highly competitive markets.

We believe that there are significant risks associated with the growing regulatory approach to corporate governance (see Figure 1). These may manifest in terms of three key undesirable outcomes, serving as decision speed-bumps for managers:

1. Boards that become directly involved in running a business and thereby restrict and hinder managers in their role.
2. Managers distracted by issues surrounding an organisation's compliance with increasing levels of corporate governance regulation.
3. Managers less inclined to take calculated risks in the running of the business for fear of contravening corporate governance guidelines.

Figure 1 Refocusing from competition to compliance: increasing the number of decision speed-bumps in an over-regulated environment



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To avoid such outcomes we argue that public corporations may need to concentrate more on devising informal and less prescriptive systems to support and reinforce good corporate governance practice. These would focus on transparent management and decision processes to expose illegal and/or incompetent activities, organisational design to enhance speed and economy of effort while maintaining open communications, and a focus on flexibility to facilitate competitive alertness as well as an openness to change.

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