

# Corporate Governance as innovative Management

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## 1. Introduction

The concept „Corporate Governance“ is an important aspect of the daily national and international discussion regarding economic, society and legal questions. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 7) Every day when you open the business section of the daily newspaper, you can read about the later case company corruption or that a manager has been convicted. Therefore it is important to create better and more secure measures regarding control and transparency within a company. The aims of this paper is to research and examine the important and crucial role of Corporate Governance procedures, such as internal and generally the suitable principles and rules for the application of the appropriate managements mechanisms for monitoring the firms activities. Innovative management procedure aims to

improve the business accountability, transparency and total performance of a company over years in favor of stockholders. (cf. Hummel, 2004, p. 5) Moreover you have to take into consideration what is happening in the two countries (Czech Republic and Germany) about the extent and the depth of application of the principles of Corporate Governance in the firms in these countries. Interesting are techniques and procedures such as the relation of Corporate Governance and management, procedures of internal audits and financial reporting. The efficiency and quality of risk management procedures and the appreciation of the total system of rules through which the firms are managed and controlled is regard to weakness, misleading, procedures and frauds. In this paper Corporate Governance will be discussed as an innovative management-system. In the theoretical part principles and problems will be

explained. The best way to get the basic knowledge for the topic is to use printmedia such as daily newspapers and books. Furthermore science-based websites are used to get the latest information. Based on a survey of European students, professors and assistant lecturers the recognition of the term Corporate Governance is demonstrated generally. After that the situation of the two countries will be described. In connection to that, the selected countries will be compared. The results will provide an answer to the question of whether Corporate Governance is an innovative management.

## 2. Theoretical background

### 2.1 Terms of Corporate Governance

Corporate Governance is a form of leadership and control of a company aimed at responsible and long term added value. (cf. Humme, 2004, p. 14) The term Corporate Governance refers to policies, procedures, structures and systems that help the company to oversee and to handle the company's activities in order to make a profit. All in all Corporate Governance includes the totality of all national and international values and fundamentals for good and responsible business management. This applies to both employees and the management of a company. It is a rules system according to which the companies are managed and controlled. None the less, it is an institutional framework which contains principles about planning, monitoring and controlling of corporation productive assets. (cf. Watson, 2005, p. 5) Moreover Corporate Governance defines the actual and legal regulation framework for the management and supervision of an enterprise. It can be distinguished between internal and external Corporate Governance. Internal Corporate Governance refers to the respect network and cooperation of the enterprise organs, to the so-called board of directors and the supervision by the supervisory board. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 7) "External Corporate Governance is the legal and actual linking of the enterprise with the environment, for example the relation of the enterprise management to the shareholders and the stakeholders." (Hönsch, Behncke, Wulfetange, 2005, p. 7) Internationally greater importance is given to the shareholders,

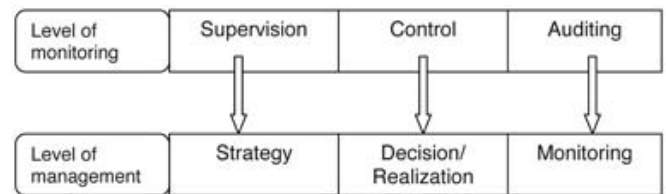
while in the European discussion a stronger focus is attached to the other interest groups.

The improvement of Corporate Governance structures serves primarily the purpose to regain lost trust of the investors in the capital markets. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 7) There are three phases in monitoring:

- Supervision (monitoring in the phases of aims and strategy)
- Control (monitoring in the phases of decision and realization)
- Auditing/ Revision (monitoring ex post of realization)

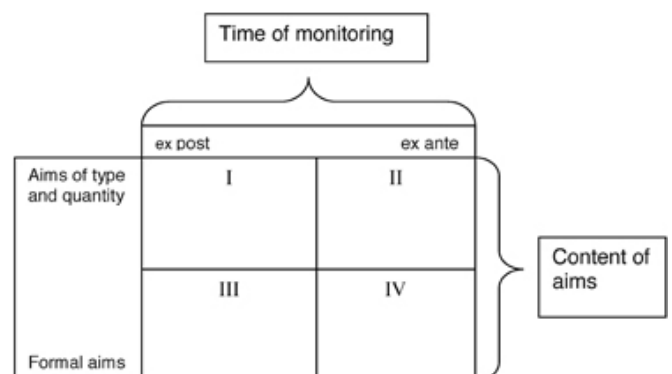
These kinds of monitoring focus directly on processes of leading a company. (cf. Kolbe, p. 66)

Figure 1: Phases of monitoring (cf. Kolbe, p. 67)



The first phase is of great significance because there the managers have the possibility to involve themselves. In addition to the chronological characterisation of monitoring, the content aspect is important, too. There are aims based on product type and quantity and there are formal aims. Monitoring standards will be developing from these elements of aims. (cf. Kolbe, p. 67) Figure 2 shows the combinations of time of monitoring:

Figure 2: Kinds of monitoring (cf. Kolbe, p. 68)



The definition of aims has a basic function because the results of processes to define aims in the same time is kind of monitoring. Financial aims are described by numbers and aims of type and quantity are more complex connections. Thus monitoring of aims of type and quantity is more difficult. (cf. Kolbe, p.68)

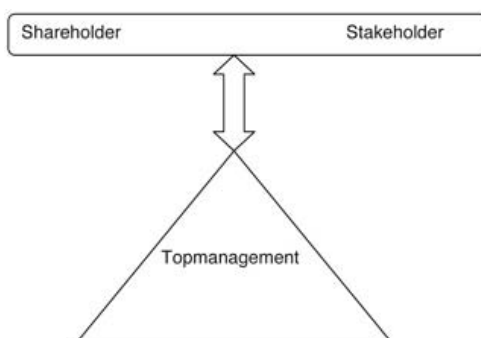
An important point is that practical application of Corporate Governance leads to a positive impact on the company capital. Firms with stronger shareholder rights have higher company value, higher profits, higher sales growth, lower capital expenditures and fewer corporate acquisitions. “McKinsey / Weltbank-Studies” (McKinsey Investor Opinion Survey June 2000) account that German companies with good C. G. will be evaluated about 20 percent higher by international investors because, for these, Corporate Governance is a very important criterion for investment decisions. (cf. Hummel, 2004, p. 16) Corporate Governance is not only effective for the companies but also for the welfare of society. (cf. Hummel, 2004, p. 16)

## 2.2. Principles and aims of Corporate Governance

Basics of Corporate Governance results from two interconnected references:

- relationship between shareholder, stakeholder and management
- the organization of decision making and control. The main point is the view of monitoring of a company. In the first place Corporate Governance refers to the leading and monitoring of companies. (cf. Kolbe, p. 64)

Figure 3: Governance of a company (own illustration)



Corporate Governance aims to discover and estimate the interests of shareholders and stakeholders. In a company there has to be a connection between the stakeholders, shareholders and top management. Good Corporate Governance gives shareholders a good yield on their invested capital through the higher valuation on the capital market and an effective increase in value of a company. (cf. Hummel, 2004, pp. 15-16)

On the one hand, principles are rights and equitable treatment of shareholders. Organizations should respect the rights of shareholders and help them to exercise those rights by effectively communicating information that is understandable and accessible, encouraging shareholders to participate in general meetings. (cf. Drobetz, 2007, p. 28) On the other hand, the interests of stakeholders are that organizations should recognize that they have legal and other obligations to all legitimate stakeholders. (cf. Drobetz, 2007, p. 28; cf. Hummel, 2004, p. 15)) Optimizing of a social and legal framework should help to minimize the conflict between lobbies and to recognize or to reduce risks in time. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 7) Mostly a deficit of monitoring is at the companies. Therefore it is important to create rules for a higher level. This should be reached by flexible codes. (cf. Kolbe, p. 64) These codes will be explained in point 4.

## 2.3. Problems of Corporate Governance

Regarding business corruption the system of Corporate Governance should secure against this, but up to this day there are some systematic problems of Corporate Governance. The demand for information is a barrier to shareholders using good information that is the cost of processing it, especially to a small shareholder. Further problems are the monitoring costs. In order to influence the directors, the shareholders must combine with others to form a significant voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting. (cf. Pascal, 2004, p. 12)

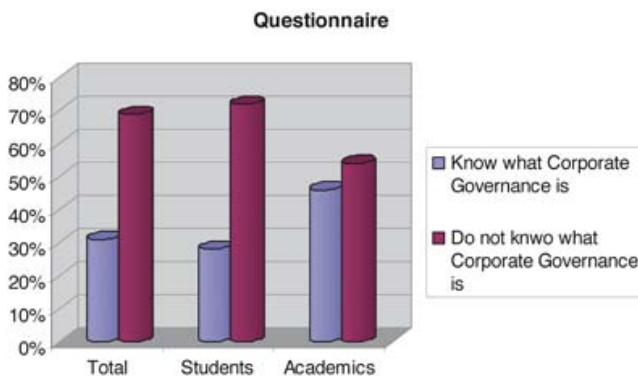
Big problems are the different interests of stakeholders and shareholders. These differences occur especially in big stock companies. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 7) Another problem is that the codes are not standardized. Thus companies do not follow the rules exactly. The observances of

codes are not monitored by public organizations. But that will be rewarded or punished through the stock market. That is the reason why report on a company does not correspond to the reality. On the one hand, it is a problem for the stakeholders and shareholders because there is no complete transparency. On the other hand, it is an advantage for the company to be flexible in monitoring and to adapt to specific situations. (cf. Kolbe, pp. 64-65)

### 3. Questionnaire

During the presentation of the project stand in Girona there is a great opportunity to do research on-site. Students and academics are interviewed about the topic “Corporate Governance as innovative management” to get information about the popularity of Corporate Governance. It is discovered that many of respondents did not know what Corporate Governance is. People who know what it is have interpreted the term in different ways. Figure 4 shows results of the questionnaire.

Figure 4: Results of questionnaire



The total number of respondent is 67. 81 percent of them are students and 19 percent academics. Only 28 percent of the students know what Corporate Governance is. With 46 percent the academics understand more about the term Corporate Governance. With a total of 31 percent, more than one quarter of the respondents know the meaning of Corporate Governance.

Everyone who know what the term Corporate Governance is, are thinking that Corporate Governance was important for companies which are active on the global market.

## 4. Corporate Governance in the two countries

### 4.1. OECD – Basics for good Corporate Governance

The Organization for Economic and Cooperation and Development are international and intergovernmental. The organization conduces to the member states for discussion, evaluation and the improvement of the policy of them. In the OECD government representative of the specific countries get together and discuss and coordinate the total economic policy and the social policy. These happen regarding basics of comparative analyses which the governments get from the OECD secretariat in Paris. The secretariat collecting data trends and analyses and predicts economic developments. (cf. Elineau, 2006) Aims of the OECD are:

- Optimal economic development and employment among ensuring the financial stability,
- Achievement of increasing economic status,
- Economic increase for the member states and
- Expansion of international trade considering multilateral and nondiscriminatory basics.

Among the 30 member states of OECD are Germany and Czech Republic. (cf. Elineau, 2006; cf. Pascal, 2004, page 11; cf. Hönsch, Behncke, Wulfetange, 2005, p. 12)

### 4.2. Germany

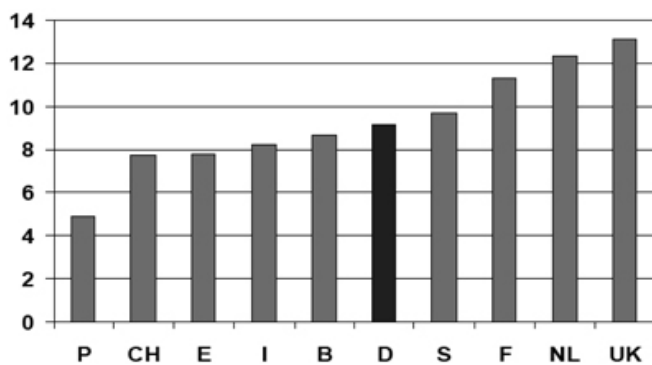
German Corporate Governance is based on the German Corporate Governance Codex. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 8; cf. Hummel, 2004, p. 12) The code contributes to making the rules for company management and control in Germany more transparent for the advantage of national and international investors. Furthermore the faith in business management of German companies has to be strengthened. The set of rules has been set up and is also developed at the same time. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 8; cf. Hummel, 2004, pp. 20-21)

In history, one can see that the development of Corporate Governance in Germany is continual. In May 1998 the law of the control and transparency in

the enterprise area and law of the relief of the capital admission are passed. In February, 2002 a first-time definition of uniform behavioural standards originated with the German Corporate Governance Codex on enterprise guidance for listed companies. An annual supplement to the German Corporate Governance Codex followed. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 1011) Furthermore there were the other legislations in Germany which used to an improvement of Corporate Governance. In Germany Corporate Governance is of great importance. It is necessary for the companies to show transparency. In a country ranking Germany arranged in the middle field (Figure 5). It is quite self-evident: good Corporate Governance tends to result in higher share prices and as a result lower cost of equity capital. “McKinsey / Weltbank-Studies” (McKinsey Investor Opinion Survey June 2000)

account that German companies with good C. G. will be evaluated about 20 percent higher by international investors because, then Corporate Governance is a very important criterion for investment decisions. Regarding this the force of market of Corporate Governance is stimulated. A corresponding direction of the companies is forced for long-term effective value. (cf. Strenger, 2001, S. 2-3)

Figure 5: European average 2001 – country ranking of Corporate Governance (Hummel, 2004, p. 9)



### 4.3. Czech Republic

The positive effect of good Corporate Governance on different stakeholders ultimately is a strengthened economy and hence good corporate governance is a tool for socio-economic development. However

the economy in the Czech Republic came from a directed to a market economy in the nineties. They make a lot of mistakes during that past periods and the business environment is not clearly regulated.

The rules of the market for corporate control are included in the Commercial Code in 1996. They have been effectively enforced only since 2001. The need to enforce such rules was especially urgent in the Czech Republic with respect to the process of concentration of shareholding, which take place after the end of the coupon privatization. The lack of enforcement of the rules of the market for corporate control, which continued for several years, seriously hindered confidence in the capital market. Thus the experience of the Czech Republic confirms the conclusion contain in the EU Plan to move forward, for example that the approach to the corporate governance rules as non-binding recommendations is inadequate and that certain key rules must have the force of law. The order which is brought to the functioning of the market for corporate control by amendment to the Commercial Code in 2001 is appreciate by the World Bank, shown by the only highest mark granted within its review of compliance with the OECD Principles of Corporate Governance of 2002. (cf. Kúdelková, M., 2006) A majority of ideas used in the 2001 Code were maintained in the 2004 Code. The working group decided to strictly follow not only the contents of the individual OECD Principles of Corporate Governance, as in the original Code, but also their structure. The reason for this closer correlation with the OECD Principles lies in the need for easier communication both with the organization itself which undoubtedly plays the leading role in the field of international cultivation of the rules of corporate governance and with other organizations. The principle of equitable treatment of all shareholders becomes one of critical importance if companies seek to raise additional capital through the capital markets and to encourage institutional investors to invest. At the present time,

the Czech Republic is still perceived as a country where minority shareholders are being harmed. (cf. Kúdelková, M., 2006) Czech shareholders should require a higher standard of Corporate Governance from companies. It concerns, for example, demands on the qualification and independence of the members of the supervisory board and board of

directors and also their evaluation. Management is often passive in the task of internal auditing and not enough attention is paid to risk management. (cf. KPMG research, 2004/2005)

There have been several instances recently in the Czech Republic where management and the boards are held accountable for the management of their companies and are forced to resign. In the Czech Republic the Commercial Code provides for the personal liability of members, both of the board of directors and the supervisory board, for their actions. Again this is an accepted international provision and this liability encourages those who are elected to the board to act honestly and with due care and attention. This culture needs to be encouraged, as it exists in other European countries. Institutional investors play an important role in this relation and must be encouraged to call for the resignation of management and board members where results or performance is weak. (cf. Klírová, J., 2001, page 128)

## 5. Comparison

The European legislator reacted on the remolded affiance because of the accounting scandals. September 2001 the EU commission attached senior group of experts for the preparation of an updating of the European corporate law. The group made a detailed statement for the management and company control. In May 2003 there are the action plan "Updating" of the law of association and improvement of the Corporate Governance in the EU. The detailed statement of the group of experts is the basis of the action plan. The aim of the plan is the strengthening of rights of shareholders, the improvement of protection of employees and creditor and the increase of efficiency and competitiveness of the companies. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 35) Regarding of European corporate law the philosophy of Corporate Governance is more or less the same in the countries examined, but there is a different way of application depending on:

- Different law, legislation and
- Different Corporate Governance codes (German Corporate Governance Code, different variations of codes based on OECD Principles in Czech and Germany). (cf. Elineau, 2006)

- Another important factor is individual company culture which differs from company to company.

## 6. Summary

Corporate Governance—is it innovative management? Regarding it is meaning, terms, principles and problems this paper whether discusses if it is innovative or not. The term Corporate Governance refers to policies, procedures, structures and systems that help the company to oversee and to handle a company's activities in order to make a profit. (cf. Watson, 2005, p. 5) The principles are rights and equitable treatment of shareholders and interests of stakeholders are that organizations should recognize that they have legal and other obligations to all legitimate stakeholders. Systematic problems like financial accounts form a crucial link, demand of information and monitoring costs are a barrier to shareholders using good information. (cf. Drobetz, 2007, p. 28; cf. Hummel, 2004, p. 5) The research conducted during the project Euroweek 2008 shows that the name recognition of the term Corporate Governance was below 50 percent of the participants. Corporate Governance is innovative because it brings new functions, auditing procedures, organization ideas in order to improve the performance of the companies. Corporate Governance Codex is a voluntary and flexible rulebook that brings transparency for shareholders, stakeholders and other participants of a company. (cf. Cromme, 2005, p. 5) Totally Corporate Governance Codex is a basic for international standards of a good management and control. In the meantime codex is more than transparency of manager's compensation. In the whole this codex is more and more successful. (cf. Cromme, 2005, p. 7)

Principal idea is standardisation of Corporate Governance in Europe. But a standardisation codex is not the solution for Europe because every company has its own spirit of enterprise. (cf. Cromme, 2005, p 13-14) An overregulation of Corporate Governance rules through state could lead that companies keep to the legal rules. Thus they do not try to get an improvement of their own Corporate Governance. (cf. Hönsch, Behncke, Wulfetange, 2005, p. 12) A possible solution would be standard principals but not standard rules and laws. A reason for that are the different legal Systems, property rights, tradition of

factoring and business culture. These differences are not to underestimate because it is apparently in the practical application. In Europe the aim is to create Corporate Governance Codes that is based on basic concept but codes should care about national qualities. (cf. Cromme, 2005, p. 13-14)

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