A Broader Perspective to Board Responsibility

Milton Friedman's traditional view of business responsibility is that social responsibilities affect the long-term efficiency of a business negatively. His famous and much quoted adage was that "the business of business is business". He maintained that "There is one and only one responsibility of a business – to use its resources and engage in activities designed to increase profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." This approach dictated the focus of the management of a company on maximizing profits within the risk parameters set for the company.

Other more contemporary authors propose that business has responsibilities to shoulder beyond achieving profit. They maintain that businesses have four responsibilities that can be prioritised as:

Economic: to produce goods and services of value to society enabling the firm to repay creditors and shareholders;

Legal: defined by government through laws that management is expected to obey;

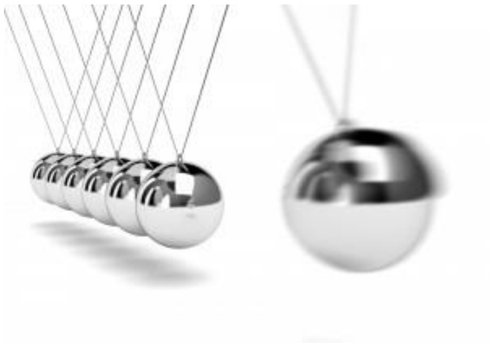
Ethical: following the generally held beliefs about behaviour in society;

Discretionary: purely voluntary obligations that a firm assumes.

In this way, social responsibility includes both ethical and discretionary, but not economic and legal responsibilities.

The discretionary responsibilities of today may well become the ethical responsibilities of tomorrow. One need only look at the way employment laws have evolved over the years, to see how discretionary practices of health and safety became ethical responsibilities. In turn many of these ethical responsibilities are now legal responsibilities. The issue of social responsibility brings into focus the large number of corporate stakeholders with an interest in a business' activities. All too often, strategic decisions will have diverse and conflicting impacts on the different stakeholder groups. Resolving such conflicts depends to a great extent on the business ethics of the organization and the understanding of the directors of these responsibilities and their commitment to their implementation.

Sustainability though Corporate Governance



It is within this broader perspective to the obligations of a business that the concepts of corporate governance have evolved. Rather than a business being narrowly focused on the profits of the company to the exclusion of all else, today's businesses need to focus on profit within the broader context of sustainable business development. It is the dimension of sustainability that provides the key to risk analysis that is essential to any business initiative. It is this responsibility to weigh the potential benefits of a proposed course of action, not only to short term-bottom line, or even to medium-term bottom line, but against the risks of consequences if things do not go according to plan. Rather than looking at the upside, directors must make a conscious effort to look at the chances of the downside actually coming about and the impact of such consequences on the viability of the business.

This longer term perspective should force directors to establish and maintain management control systems to ensure that the strategy of the company is being correctly implemented. The proper implementation of corporate strategy includes the proper assessment of risks facing the business and the operation of the business within the levels of risk accepted by the Board. Such business risk may involve the selection of lines of business, countries within which the business will operate in, business practices to adopt, safety standards and procedures to be maintained, etc.

It is the shareholders who elect the board of directors to represent their interests in the company. The directors are not there to represent the specific interests of shareholders, even if the shareholder is a majority shareholder. They are there to seek the best interests of the company. To do so, the shareholders, through the provisions laid out in company's memorandum and articles of association, give them the authority and responsibility to establish basic corporate policies and approve strategic decisions. Management must then run the business operations along the guidelines set by the directors optimising the use of resources of the company.

Corporate governance thus refers to the relationship among these three groups in determining the direction and performance of the firm. The most critical risks of a business are those with strategic implications. Understandably, the further away is the outcome of a decision, the more difficult does it become to predict with accuracy such an outcome. Investing in a project which is going to materialise in ten years time is far more difficult to predict that one which comes to fruition in ten months time. It is not surprising that such higher risks need to be dealt with by the Board of Directors and not by the management of the company. The latter will of course make the relevant recommendations and should be very much involved in the decision making process, since ultimately management will be responsible for the implementation of the decision. However, it is the Board of directors that carries the responsibility for the validity of the long term decisions being made on behalf of the company, which are an essential part of the strategic plans that need to be approved by the Board.

“Controls over director’s powers”

The Institute of Directors in the UK provides a valid framework within which to set the parameters of control and accountability at Board level. Their factsheet titled “Controls over director’s powers” sets seven limitations to the directors’ activities:

1. Act within powers

2. Promote the success of the company

3. Exercise independent judgement

4. Exercise reasonable care, skill and diligence

5. Avoid conflicts of interest

6. Not to accept benefits from third parties

7. Declare interests in proposed transactions

The IoD thus recommends that directors are responsible to perform their role within these parameters; they are accountable to the General Meeting and should demonstrate to the meeting that they have successfully carried out their duties and responsibilities within the parameters set for them.

Conclusion

One of the basic adages in management practice is that “you cannot improve performance unless you first measure performance”.

Achieving a company-wide commitment to improved standards of accountability calls for leadership by example. It is up the board of directors to set the example for the rest of the company by setting itself standards of performance and measuring the individual levels of performance of each director against the pre-determined standards. It needs to be seen to be working to high standards of performance to give credibility to its demands for high standards of performance across the company.

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