

FEAR, REGRET AND TRANSPARENCY

CORPORATE GOVERNANCE EMBRACING DISCLOSURE AND INTEGRITY

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ABSTRACT

Lack of information and responsibility within risk management, among board members and top management, and homeowners has all contributed to the current global sub prime mortgage crisis. Similarly a lack of appropriate governance and risk management to the temptation of short term profit prospects led to the Asian crisis of the late 90s and the corporate ethical disasters of Enron and WorldCom. Those apparently unrelated events led to regret and even fear. Moreover, they also resulted in stricter regulatory oversight. The main question is how to overcome fear and regret amid recurring economic crises? This paper argues that converging global corporate governance principles and best governance practices may provide the first steps to institutionalize reform to contain global crises. Those practices embrace generic principles of institutional transparency, personal candor and attention to an attitude of integrity while best governance practices acknowledge the local context in which institutions and corporations function. Despite some costs incurred in increasing transparency, *institutionalized disclosure* and *individual integrity* can make a difference to guarantee appropriate corporate behavior that may strengthen the corporate decision-making process and could bring back confidence and trust in those corporate and financial institutions and their leadership.

Key Words: *financial and corporate crises, governance principles and “best” practices, transparency and opacity, regulatory oversight, institutional disclosure and individual candor*

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There does not seem to exist any commonality between the ongoing financial global sub prime mortgage crises and the Asian crisis of the late nineties on the one hand and anti-corruption corporate campaigns on the other hand. Or is there? Indeed, there is. We believe that there is an indication that something under the surface links the causes of those phenomena: a lack of *institutional* and or *individual responsibility*.

Cutting corners or taking the easiest way while avoiding accountability may not seem unexpected in a competitive business environment. It may even be considered as normal behavior to satisfy the investors' expectations to continue to provide continuously growing or persistent quarterly earnings per share. Improving corporate responsibility on an institutional level and candor aligned to integrity on an individual level could counter some of the lost trust and confidence. Those at the centers of power and authority have corresponding duties and responsibilities to fulfill for which they can be accounted for through processes of transparency.

Transparency is a central pillar of Good Corporate Governance. Increased disclosure and transparency are crucial for effective risk management as part of corporate governance. The notion of transparency that presents a truth claim reflects a new value in the information culture in general and more particularly in an increasingly global business environment. Transparency refers to an open society in which a thriving business requires valid information about markets that implies risks and opportunities. Transparency can be firstly seen in the context of a new digital reality of more disclosed data turned into information and knowledge within and between organizations or secondly in terms of personal responsibility, *alias* integrity. Generic governance principles are translated into contextual sensitive practices of improved institutional disclosure and enhanced individual accountability. Those "best" governance practices could substantially reduce though not eliminate the likelihood of crises and or corrupt behavior by corporations. However, a shift to more transparency is only possible by a moral culture shift that breaks certain taboos and the "silences" of the past.

This paper will firstly analyze some reasons why a lack of responsibility and weak governance practices is at the root of those apparently unrelated crises and corporate ethical debacles. Greed, neglect and ignorance cannot be a valid excuse for those failures. A quest for converging good corporate governance principles are part of the solution in this increasingly complex and uncertain global interdependent economy. In a second part we emphasize the aspects of transparency as a fundamental underlying aspect of those converging good corporate governance principles. Transparency can be institutionalized through improved information disclosure requirements, either mandatory or voluntary, within a less opaque society.

Nonetheless, one should be guarded against overzealous or unwise quests for disclosure, since reducing asymmetric information has its costs as well. In a third part, we argue that improved individual integrity, accountability, personal candor and professionalism of top management should enable the organization to lift towards visionary and sustainable business strategies. Moreover, without transparent responsibility, business leaders will not be able to regain trust and confidence which regrettably and fearfully have been lost in these recent crises.

REGRET AND FEAR VERSUS TRANSPARENT RESPONSIBILITY?

The world currently seems to be in the grip of fear and regret caused by the securitized mortgage instruments meltdown that led to a systemic global financial crisis. Similarly, being caught in a corporate corruption scandal usually brings along the emotions of fear and regret. The implication of greed, neglect and ignorance can be far reaching and its consequences sometimes quite intrusive. But fear is hardly ever a reliable guide and regret usually comes too late since the damage has been done and its consequences can be quite dramatic, either on an individual or on an organizational level. Our conviction is that a *lack of transparent responsibility* that is translated into *opaque governance rules* and *non-responsible* and even *outright greedy behavior* are partially responsible for the current global financial problems and corporate debacles. Global competition and recent corporate disasters have brought pressure for improved corporate governance and more particularly transparent leadership to the forefront, both in the West as well as in the East. Being transparent indicates that light is allowed to pass through so that objects can be clearly seen; it also means “without guile or concealment, open, frank and candid.” Hence, transparency in the current social and business context can be defined as the social value of open institutional and/or individual access to particular information held and disclosed by centers of authority who supposedly function as ‘stewards’ and ‘guardians’ of information on which corporate entities are based, for the sake of their respective owners and ultimately for the sake of the public at large. Moreover, corporate governance cannot be meaningfully analyzed in isolation, independent from the role of institutions and public governance that both concerns transparency¹, fairness and the legal system of the market mechanism. The recent financial crises seem to be caused by the antipode of transparency. A common factor determining the success of a corporate governance structure is the extent to which it is transparent to market or regulatory forces.

Crises do not come unannounced. We just do not seem to respond to those tacit or explicit indications till too late. The current Sub Prime Mortgage Crisis in the U.S.A. shows that

the price to be paid for lacking transparency and accountability in the securitization process of mortgage loans (Collateralized Mortgage Obligations or CMOs) has proven to be very costly in terms of loss of credibility, reputation, market share and value. The financial meltdown starts to show its negative repercussions in the real economy, resulting in an economic recession that could easily last till the first quarter of 2010 or way beyond. It is unnecessary to mention that it is not [just] the overzealous risk-taker but [most likely] the taxpayer who will pick up this expensive bill. What went wrong? Excessive credit, excessive leverage and excessive funding were at the root of the subsequent panic in September-October 2008 that led to systemic illiquidity and insolvency to be rescued by the respective governments in the world². *Excessive credit* was made possible through “dumb money” where investors were looking for yield in high rated securities, hind insight wrongly rated as non-risky by the international rating agencies. Since investment banks and the securities packaging companies started to sell more and more of this “toxic waste” without recognizing the potential risks, fed by cheap credit that lured sub prime borrowers to take advantage of the free lunch available, a lack of oversight made the meltdown, hind insight once mroe, inevitable. Competitive pressures at the top of those banks and a well-known herd-effect pushed them to purchase and keep those securitized loans on their own books instead of further mitigating the risk. Moreover, one can argue that there was a *lack of full internalization of those risks* in the banks buying and selling those CMOs. Even if risks were expressed by the respective risk departments, they became less efficient as the cycle of buying and selling those securitized loans was progressing and in fact at the height of the danger, risk management was at it weakest. There was a total breakdown of applying the appropriate governance principles because more leverage was taken on the balance sheet without providing any cautionary cushion. In addition, the short term credit was considerably cheaper than long term capital with the idea that one could keep the borrower on a short leash. No one was building reserves, one paid out the cash to their top executives as bonuses for the short term profits generated through this apparently profitable securitization process till the presumably golden eggs broke in August 2008. It seems that the institutions were not prepared to support the increasingly complex financial securization process and the related mortgages which were not that risk-free as wrongly presumed. Moral hazards, and the failure to anticipate quite obvious risks aggravated by “irrational exuberance” at the prospects for profits partially explains the bubble (Shiller 2008³). Finally, the *excessive funding* for mortgage loans paradoxically lead to illiquidity and insolvency as those loans unexpectedly started to mount, securitization became increasingly more complex (un)consciously hiding any risk. Pricing of these mortgages-backed securities became harder by the day. The myth that there was plenty of money available was finally unraveled in August 2008 and panic erupted when

Lehman Brothers were not bailed out by the USA government. The rest of this mortgage story is history in process now.

What can be learned from this particular crisis? Illiquidity is contagious. Although hedge funds are usually better equipped than regulators to monitor risk, one pushed the bottom of risk-taking profitability a little too far. By imposing enormous reserves for risk taking, money was pushed away by securities houses and investment banks – which are comparably less dictated by regulatory oversight than traditional banks - to off-balance sheet activities out of sight of the regulator. Excessive greed motives for example overtook the fear for too high risks within the opaque hedge-fund business. It is acknowledged that a governance problem should not be equated to a regulation problem. Having a variety of markets and instruments, institutions, government intervention and global oversight coordination can help the system to regain some form of confidence rather quickly. Financial infrastructure should be strengthened. Obviously, the private sector needs mechanisms to absorb this crisis, and not just put the tax burden on the public at large. Such improved mechanisms will imply some form of governmental regulation that underpins the support for the financial sector without stifling innovative and creative new products and services. However, the “Washington consensus” who advocated a strong belief in open, free markets, and general acceptance of faith in the efficiency of the market, presumably worldwide, seems to be in retreat in the face of the current global financial meltdown. The Obama economic team and the EU leaders have clearly indicated during the G20 Summit in Washington on 15 November 2008 and on a number of occasions afterwards that government intervention will be needed to address the global crisis and rectify the “free” market. Moral hazards linked to the market mechanism needs to be minimized by better oversight, less opacity and stricter accountability, not by more bloated regulations that could cause to aggravate the current crisis situation. It can be suggested that in the short term the government has no choice but to bail out which unfortunately has the side effect of encouraging moral hazard as in people acting irresponsibly because they expect a bail out in case of failure (Shiller 2008). In the long term, an improved information infrastructure is needed allowing people and firms to use an improved knowledge base through transparency processes. Such improved framework will imply that the Rating Agencies will need to be more effective and made accountable for their advice as well. They grossly over-rated the CMOs; now they have changed shoulder and are about to over-react in the pessimistic sense by about to downgrade some South European countries, possibly causing unnecessary long term damage. A more moderate, less erratic and ‘objective’ attitude from financial institutions, including the Rating Agencies, should be expected. If not, their existence becomes redundant and dysfunctional. The role of policy- makers is not only to enforce current

laws, but to promote institutions that facilitate market discipline (Low, 2005). Second, commitment to value creation through or under the constraint of moral values, and social norms will help an accountable leadership to prepare and implement visionary strategies. It is within limit(ation)s that a system can optimally function.

Similarly, the Asian Crisis of 1997 highlighted the inadequacy of systems of governance at the state level as well as at the corporate level. During that crisis, the five most heavily affected countries - Indonesia, South Korea, Thailand, Malaysia and the Philippines - lost more than USD 600 billion in market capitalization⁴ or around 60% of their combined pre-crisis gross domestic product. Total private capital flows to emerging markets are estimated to have fallen in 2002 to levels last seen in the early 1990s (Cornelius, 2003). The predominant relationship-based style of corporate governance can be seen as one of the fundamental drivers of concentration of ownership accompanied by a lack of transparency has turned out to be one of the causes of the region's economic crisis (Millar *et al* 2005, Pye 1997). However, the Asian Crisis has brought considerable progress in a more transparent corporate governance mechanism and more comprehensive and internationally converging accounting standards in the respective inflicted countries. In the ASEAN banking sector for example, a substantially improved transparency and decision to adopt the International Basel II standards⁵, allowed for a drastic change from close and intrusive regulation to a risk-based supervisory regime in most of those ASEAN countries (Rhandawa, 2005). Such amelioration may prepare them for a more robust and sustainable growth in the future.

At one extreme of the pendulum of information one finds *secrecy* that corresponds to traditional loyalties and hierarchies whereas at the other extreme *transparency* oozes a fundamental respect for individual autonomy while acknowledging growing interdependencies of the global participants. The ideal of transparency assumes that more information about the functioning of a publicly listed corporation reduces the likelihood of corporate misbehavior and increases the chances that it will perform better. However, only if a firm is fully investigated by a regulator or institutional authority is it truly possible to verify the information it provides. In short, a company can be fully transparent and still be fraudulent. Enron and Parmalat are two by now infamous cases that prove this point. Both disclosed massive amounts of data as required under their respective capital market regulators, and in both cases, they were able to deceive the public. Despite being allegedly transparent about their internal financial data and codes of conduct, they did not tell the truth. Moreover, one can easily imagine corporations that are stellar performers without being fully transparent.

After these public scandals of corporate appropriations, the quest for *business legitimacy* has become a top priority aiming to indicate that corporations could be accounted for their actions and subsequent consequences. *Institutional transparency* (Part 2), either mandatory (as for financial information relevant for investors) or voluntary (as found in ecological and ethical information relevant for stakeholders), is a necessary but not sufficient condition to guarantee responsible and “accountable” behavior. *Visionary leadership* (Part 3) is needed to fill that gap which obviously is much harder to assume in a competitive global economy.

Two caveats should be mentioned though. Sometimes, less transparency could lead to better performances or even greater efficiency in the short term. The analogy between an open society such as in India that may be slightly less competitive or efficient compared to a closed society such as in China. The latter has grown more quickly and raised more people out of poverty more rapidly than a democratic India. And the second danger lingers that – along with an overzealous discourse about human rights and democracy – transparency has become another buzzword that presumably tries to demonstrate the supposed moral superiority of Western governance principles over the rest (Mahbubani, 2008). “It is hard not to wonder how much of that discomfort of a lack of transparency [of Asian and Arabian investment whose inner workings are indeed opaque] and how much is about the shifting power balance in global finance” (Karabell 2008: 41).

In emerging markets, majority and family ownership are quite common, disclosure levels are low, shareholders’ rights are sometimes ignored, and judicial recourse is sometimes very uncertain. Asian corporations deploy opaque accounting principles, keeping the data ‘in the family’ and practice ‘gift giving’ on a scale that could be interpreted as bribery in an Anglo-American context. In Asian Cultures the lack of trust beyond extended family, collectivism and cultures of power distance based on hierarchical status elevate the importance of certain socially acceptable behaviors such as loyalty and close personal relationships in business. These specific cultural and organizational characteristics, important to sustain *social capital*, may turn into cronyism which selects and favors some “in-group members” based on relationships and loyalties, or can overemphasize relationships and loyalties that can result in corruptive behavior (Khatri *et al* 2003; Verhezen 2008b). Such cultural complexities may hinder and even undermine the development and implementation of the good corporate governance required for sustainable ‘modernization’ in a global interdependent world. The objective of corporations in today’s world should be to underwrite broader principles, finding a way of going beyond the contextual content of a particular community and reaching some universal validity beyond cultures or ethno-centric perspectives. It seems that a certain convergence concerning governance principles and corporate

citizenship can be established beyond cultural borders. Adhering to certain “transparency” principles would help to reach such goals. Indeed, it can be argued that some socio-philosophical framework of *global* governance *principles* should be suggested while respecting and emphasizing the cultural historical context of its *local practices* to take on the enormous global challenges.

Both the Asian Crisis in the East and the Sub Prime Crisis in the West suggest that governance on a global level will need to be taken seriously because they demonstrate that an occurrence in the East impacts the West and visa versa. Business is embedded in institutional settings and socio-economic and political contexts of both a material nature, in terms of money and tangible physical assets and a nonmaterial nature, meaning intangible assets such as credibility, good will, trust, social capital and reputation, which influence governance systems. Identifying *common trends* will become more and more related to the growing convergence of some institutional settings by the globalization process. Despite the benefits of effective governance practices and the pressure from globalization forces, changing governance models is not easy because they are embedded in a national institutional environment (Zattoni 2008). Although economies with sound disclosure levels in the banking system, which in turn is related to the notion of transparency in public decision making, suffer lower level of corruption whereas Thailand’s and Indonesia’s rating in Transparency International for example has not seemingly improved since the 1997 crisis (Randhawa, 2005) and transparency is still a far cry, keeping away a number of potential foreign investors. Modifying governance practices often requires amending laws and, therefore, agreement between the political and corporate elite on the governance model to adopt.

Despite the fact that the convergence of governance principles⁶ seems to be orientated towards the Anglo-Saxon model, significant differences still exist between countries and regions when it comes to disclosures of various board sub-committees. The current global financial crisis seems to hasten the ongoing trend of convergence of universally accepted accounting principles. The US GAAP seems to be destined to look more and more aligned to the European International Accounting Standards (IAS). Indeed, in spite of the global nature of today’s competition, the political, economic and socio-cultural effects of local market institutions can have both positive and negative influences on firm capabilities and competitive advantages (Millar *et al* 2005; Kogut 1991). It is difficult to envisage a complete convergence of corporate governance practices in non-Western legislations because of significant differences in culture, legal translation, history and path dependence (Ho *et al* 2004). However, a growing demand for global financing logically induces those firms to adopt governance mechanisms and processes that are accepted on a global

basis. It is not too difficult to see that most of the “best” governance principles are focusing on assuring that managers of companies are fully accountable to shareholders. A common platform in corporate governance principles is becoming a necessity to guarantee and sustain international financing from institutional investors or even to gain a competitive edge through a superb corporate reputation. Moreover, increased disclosures are associated with market liquidity, reduced cost of capital, and greater overall transparent responsibility. Adhering to those transparency principles allows greater access to global competitive financing and global skilled talent. But it is doubtful medium and smaller companies in Europe, Japan and Asia in general are adapting those strict formal Anglo-Saxon disclosure principles, despite an obvious convergence among the big multinational corporations.

Prior to analyzing the notion of transparency more in detail, it is worth asking what those more generic governance principles and “best” practices are. Corporate Governance can be re-defined as the interactions between coalitions of internal and external actors and the board members in directing and *steering* a corporation for value creation (Huse, 2007; Brown & Caylor, 2006). Good corporate governance refers to the exercise of power and responsibility for corporate entities (Mallin 2002). Corporate Governance can be defined as structures of relationships and corresponding responsibilities among a core group consisting of shareholders, board members and managers designed to best foster the competitive performance required to achieve the corporation’s primary objective of profitability (Solomon & Solomon 2004). Moreover, good corporate governance’s concern for capital providers or investors is related to assessing risk in investments in a firm’s resources, to evaluating capital allocations to provide reasonable returns and to monitoring how capital is managed over time (Puffer *et al* 2003; Banks 2004; Clarke 2007; Huse 2007). One of the main objectives of corporate governance is to provide reliable information about the firm through transparency and disclosure to all shareholders. Indeed, we can safely assume that good corporate governance principles refer to and are concretely translated into an obligation of *care* and formal *fiduciary duty*⁷ of officers and directors that accommodate the shareholder value. The former refers to an *attitude of responsibility* towards all shareholders and stakeholders embedded in informal *social capital* structures affecting the company. In other words, dramatic changes in cultures of information require access about and from centers of power and their accountability leading to the “right to know” and expanding “duty for disclose”.

The reasons for improved good corporate governance could be either to improve efficiency or to legitimize institutional investment (Zattoni *et al* 2008). The traditional agency theory emphasizes the formal corporate governance mechanisms that focus on controlling and monitoring of management by the Board (Fama & Jensen 1983; Jensen & Meckling 1976; Jensen

1986 and 2002). However, such a formal approach should not ignore the more informal corporate governance mechanisms that underpin resource-oriented and relationship-based governance (Peng 2003 and 2005; Pfeffer *et al* 1978; Hu & Verhezen 2009). Corporate governance principles are justifiably considered as a needed check and balance system of the top management who run the firm on behalf of the owners. However, in the UK, both the Cadbury (1992) and Hempel (1998) Report respectively warned against the dangers of over-emphasizing the control role of non-executive directors at the expense of their strategic role (Roberts 2005). Our personal experience in Asia confirms this view: the importance of personal *guanxi* and reputation of leadership can only be ignored at one's own peril. In most ASEAN countries and other emerging economies, poor enforcement of disclosure laws and accounting standards stifle regulatory authorities unable to monitor banks and public companies for example (Randhawa, 2005).

In contrast to the agency model of the board as a control mechanism, it is suggested that boards have a broader, more inclusive role, with non-executive directors involved in giving advice and embracing strategic discussions (Roberts *et al* 2005). Actual board effectiveness depends upon the behavioral dynamics of the board, not on the formal procedures. It largely is dependent on how the web of interpersonal and group relationships between executives and non-executives is developed in a particular company context. It seems logic that organizations will respond to changes in their environments by initiating strategic change to adapt to changed situations. Empirical research indicates that changes in the environment usually motivate changes in the structure and composition of the board of directors as an environmental link (Pfeffer 1972 & 1978; Hillman *et al* 2000). Relationship-based governance and a resource-oriented mechanism should be acknowledged in improving the effectiveness of the board and the need for more transparent responsibility under the constraints of formal disclosure requirements and informal moral integrity (Verhezen & Morse, 2009). Without appropriate information based on more transparency, it is impossible for non-executive board members to develop a confidence that top management is focused on the most appropriate indicators of business conduct and performance.

Where boundaries as result of globalization and internationalization seem to be fuzzier than ever the need for some multi-fiduciary responsibilities within and for a corporation may become recommendable. Adapting to a multiple-principal-agent theory, quite often referred to as the stakeholder theorem (Jensen 1983, 1986, 2002; Freeman, 1984; Donaldson, 1995 & 1996), instead of a naïve belief in the single principal-agent theory and its exuberant laissez-faire model based on individual self-interest only will have more chance to embrace necessary changes to address the global challenges. In other words, when we imply that corporate governance should also be applicable to medium-sized and smaller firms – i.e. the majority of companies are small or

medium-sized in the world at present – a corporation can be seen as a bundle of resources and relationships that produce an output in the form of wanted or needed goods and services. Hence, the authors will opt for a broader definition of good corporate governance, which takes into account the relationships between shareholders, their board members and top management on the one hand and the different stakeholders who could significantly affect the value of the corporation on the other hand. The fiduciary duty of acting with due care by the boards of directors to the shareholders and by corporate managers to the corporation is here broadened and embraces prudential considerations of how the relationship with other stakeholders could be affected by corporate decision-making. It seems that quite a number of Asian companies are implicitly concerned with community development though hardly in any formal or procedural manner since they underwrite and acknowledge the good relationships with external stakeholders and community members as a necessity to survive. The authors are compelled to underwrite the argument that the interests of stakeholders other than just shareholders could and should be taken into account provided that, as the Delaware high court phrased it rather delicately in a well-known case that there is “some reasonable relationship to general shareholder interests” (Dimma, 2002: 166) which nowadays is seen as mainstream corporate governance practices. The enhancement of stakeholder interests from a board perspective is defensible and necessary, especially if such an argument protects the best interests of the firm, even though such interests may appear incongruent with non-financial goals⁸. The fact that nowadays boards take into account stakeholders’ concerns that can affect the reputation of organizations, with sometimes dire financial consequences, seems to have become mainstream governance practice. The subsequent debate is now raging as to what extent corporations should be indeed aspired to be fully fledged corporate citizens in a global village (Mirvin *et al*, 2006; Emerson, 2003).

Value is not merely profitability for shareholders in the form of dividends or stock price increases, but value is created throughout the whole value chain. Remaining deeply engaged with all critical stakeholders and developing an emotionally resonant shared purpose for their employees and other stakeholders seem to be one of the corporate features for successful corporations (Eisenstat *et al*, 2008). Most CEOs and directors in the West are rightfully concerned with the changing expectations and increasingly critical demands of stakeholders and the associated risk that are affecting their corporate reputation. They are also aware that they, and not just the regulators, need to lead the way forward to address the increasingly complex global challenges.

Traditionally corporate governance mechanisms imply the importance of reasonably independent boards to nominate top management, determine their remuneration packages,

guarantee corporate continuity through succession planning and make sure that information is properly disclosed through internal and external auditing processes. The most active institutional investors' expectations regarding corporate governance⁹ can be summarized in the following well respected "best" practices: the quest for an increasing number of non-executive and independent directors, the splitting of Chairman and CEO roles, the creation of board committees (nomination, remuneration and the audit committee) made up by non-executive independent directors, and the development of an evaluation procedure for the board are all formal practices considered to increase board and firm performance (Banks 2004; Clarke 2007; Markarian 2007). However, there are *no* "best" or optimal systems of governance, but there are only *better* practices¹⁰. Indeed, it is acknowledged that a 'one size fits all' approach is unrealistic and often perceived as alien because experience has demonstrated that the Anglo-American capitalistic structures cannot be automatically transplanted or imposed globally. Nonetheless, investors can only be attracted to buy foreign shares if *basic standards of corporate governance* at an international level are being adhered to (Verhezen & Morse, 2009). When the fund manager Mark Mobius, from Templeton Asset Management, joined the board of Lukoil the market reacted by positively reevaluating Lukoil as they were convinced that Templeton being involved would bring more transparency and accountability to the Russian company, enhancing the overall value of Lukoil in the process.

No matter how powerful and technologically sophisticated the train, it is only as good as the track on which it runs and as the conductor who steers the train. The mortgage crisis has revealed that the regulatory and insurance institutions are like old tracks not suitable for the new challenges. Moral hazard can only decrease when institutional reform provides a stronger framework within which the real estate and financial markets can effectively operate (Shiller 2008). Such institutional reform does not equal more regulations; more likely it will require streamlining, adopting, and fine tuning the existing regulations. Moreover, the lack of corporate governance principles and too much greedy focus on quarterly bonuses has definitely aggravated the financial meltdown. Whether corporate governance certainly reducing overall risks would have been able to prevent the crises altogether is more difficult to assess.

THE QUEST FOR IMPROVED TRANSPARENT RESPONSIBILITY IN A GLOBAL WORLD

To what extent is the notion of transparency a prerequisite of Global Corporate Governance Principles and Practices, especially in non-Western societies? Globalization is creating a political, economic, social and ecological environment that needs to be governed in a responsible manner where political choices and corporate actions need to be taken to address the global challenges, especially by those in power. Accountability of those in power relies on the value of trustworthiness that could inspire a culture of transparency, candor and individual responsibility, providing the “glue” for a new phase of a global fairer world. A “trust and verify” attitude can only be enabled through greater transparency and measures of accountability.

Transparency and creating a culture of candor refers to the free flow of information within an organization and to a high extent between the organization and its many stakeholders. It often requires the leader’s commitment enabled by a particular organizational culture that is governed according to certain principles. Where information travels globally throughout Ethernet, transparency is no longer “nice to have”. It has become a necessity to survive in this digital area. An institutionalized form of transparency clearly states that financial and to a lesser degree non-financial data need to be disclosed to shareholders and other relevant stakeholders. On the other hand, it is essential for companies to implement initiatives that prevent and manage employee misconduct. The latter requires an effective code of conduct or compliance program that must become a part of everyday corporate governance whereas the former needs strict adherence to regulatory compliance. At the same time, one should acknowledge some legitimate limitations to transparency.

Global Governance Principles, Best Practices and Transparency in an Open Society

Many countries in South East Asia and China with insider-dominated systems have focused on improving the legal protection of minority shareholders, concentrating on improving corporate accountability by forcing companies to produce consolidated accounts and to encourage greater dispersion of equity ownership¹¹. Cultivating a broader shareholder base will likely result in greater shareholder democracy (Solomon *et al* 2004) and increased shareholder activism. There is definitely a pressure towards global corporate governance compromises. Such a trend would imply that reforms in systems of corporate governance implying a relatively high level of transparency both in the West and in the East will focus on long-termism and accountability¹².

In the governance and financial literature, transparency is related to the continuous dissemination through accessibility to media, consistent communication with stakeholders and periodic disclosure of firm-specific information on a voluntary or mandatory basis (Bushman et al 2004; Yadong 2005; Patel 2002; Pope 2003). Such disclosure and dissemination can have a positive efficiency effect in obtaining capital (Uren 2003) or enhance the firm's reputation (Bennis 2008; Fombrun 1990, 1996, 2000). In some cases, firms in countries with weak investor protections and disclosure standards may choose to cross-list in countries with stronger standards and requirements with the aim to attract and protect additional (minority) shareholders (Reese, M. & M. Weisbach 2002).

Transparency is linked to the value of respect for individual autonomy that often leads to a form of *generalized trust* in an open society. Moreover, such an attitude of transparency logically requires access to needed information, based on the assumption of reasonable assessment of truth claims by the public at large. Obviously, any change in values as expressed in the demand for more transparency arouses resistance. This is in contrast to the notion of *secrecy* that limits individual autonomy and is linked to hierarchies, obedience and discretion, resulting in some form of *particularistic trust*¹³ in a closed circle only. Secrecy – hiding information intentionally – should be distinguished from *opacity* – absence of information, sometimes manipulated. Opacity is the lack of transparency, and is easier measured than the notion of transparency itself. Kurtzman's opacity index¹⁴ gauges the economic costs to nations which lack transparency (2004 & 2007). Opacity and secrecy have long been ancient tools of authority in most, if not all, societies. Obviously, both secrecy and opacity are still powerfully entrenched and even increasing in some domains, especially in response to security threats or for the protection of illicit gains and privileges of special interests (Holzner & Holzner 2006). Calling for more transparency can be easily perceived as an onslaught against tradition, identity and security, as well as against the established authority and power of the governing elite. It can also be seen as a fight against corruption, inequity and authoritarianism, and for freedom, openness, civil rights and personal autonomy (Holzner & Holzner 2006). The key to any good investment is clarity while the lack of transparency and candor erodes trust and discourages collaboration.

Transparency is a present condition as well as an emerging norm, presupposing the idea that betrayal should be avoided. The demand for more transparency expresses an ideal of accountability. From that perspective, *lies* should be distinguished from *secrecy*. Under the modern global conditions in a complex political and economic environment, lies have become much more devastating than in traditional societies. Lies can question the very foundations of our life and should therefore be more severely penalized in modern societies in comparison to the

simpler traditional communities. However, keeping secrets is necessary in antagonistic relationships, but it also may be chosen as an instrument of strategy in interactions among partners to time a particular revelation or strategy announcement, to prevent premature public debate about incomplete project plans, or to make surprises possible among others.

Changing in values of information cultures are often linked to changes in identity and morality in a prevailing context. That the last twenty years of fast developing information and communication technology has created enormous new opportunities unheard of two decades ago as well as threats such as a loss of privacy and increased surveillance cannot be ignored either. Nevertheless, transparency is not about eliminating privacy but it is about holding powerful people accountable in case of violations. Like markets, governments hardly function well in the darkness of secrecy. Scandals have played a special role in stimulating the demand for more transparency. It is indisputable that practices such as capitalizing lease payments – as in the case at WorldCom – or hiding investments in partnership – as over-exercised in the Enron case – are wrong. The adoption of new accounting practices, auditing oversight, and rules for managerial liability makes sense given their abuses (Cornelius, 2003). Transparency is effective to the extent that centers of authority, citizens, customers and clients construct valid information and achieve a common understanding about it. Hence why an open society almost becomes a prerequisite to allow transparent responsibility to assess information and understand it.

Globalization, deregulation and privatization are assumed to dramatically change the competitive dynamics. The more intense the competition, the more transparent the markets and the lower the switching barriers for customers, the more important it is to persuade customers of the value of a product or service (Bailom *et al* 2006). Hence, the focus on customer value. The need for a global convergence in corporate governance derives from the existence of forces leading to international harmonization in financial markets (Solomon & Solomon 2004). We observe a certain trend towards international harmonization if not immanent convergence in the areas of accounting and financial reporting with the ‘principles-based’ International Accounting Standards Board (IASB) driving towards a comprehensive set of internationally acceptable standards for accounting aimed at a global standardization with the ‘rules-based’ GAAP. An obvious example is the fact that stock options granted to top management as a performance dependent remuneration are off balance and thus not considered as a real expense until materialized at the maturity date according to the GAAP, whereas the IAS 39 clearly stipulates such a security as a real cost that needs to be immediately cushioned against its fair value through capital for possible future risk. Although compensation through stock options is rarely practiced in East Asia or China - unless with explicit professional partnerships - we believe that, with the

growing internationalization of companies and the increasing pressure to find or to retain talented management expertise, these Western ingrained practices may gain some prominence in Asia in the not too distant future as long as appropriate capital reserves are recommended and foreseen as a cushion for the risks taken.

Political, institutional and market pressure seem to be the main drivers of a convergence of corporate governance principles and to a certain extent even its practices. Empirically it can be argued that the globalization of reasonably free capital flows and the increasing relevance of globally active institutional investors who take an active share-owning role have been instrumental to move towards a more coherent and internationally accepted governance model that emphasizes improved disclosure through transparency and accountability.

It should be noted that governance will not completely prevent misconduct or misdeeds, but it can actually improve the way a corporation is run. Ultimately, a company with good governance structures in place will attract talent, skilled management¹⁵ and investors who are willing to pay a premium for stockholding in a well-managed and transparent corporation. A McKinsey survey (2001) has proven that foreign investors are willing to pay considerable premiums (between 20% up to 30% above the market stock value depending on the country of origin of investment) for companies in emerging countries which implement internationally recognized 'minimum' governance standards. Higher transparency and better disclosure reduce the information asymmetry between a firm's management and financial stakeholders, i.e. equity and bond holders, mitigating the agency problem in corporate governance. Other research suggests that firms with higher transparency and disclosure are valued higher than comparable firms with lower transparency and disclosure (Crist 2003); it shows that the Asian emerging markets exhibit greater transparency and disclosure following recent crisis (Patel *et al* 2002). In other words, markets place a premium on companies with lower asymmetric information problems. The financial crisis has urged ASEAN countries to undertake drastic measurements to improve their transparency that under grid their corporate governance. Especially in the ASEAN banking sector, severely hit by the financial crisis of 1997, which is increasingly interlinked with the global financial markets, have started a consolidation process and has reacted to the market by improving their corporate governance mechanisms. The implementation of the Basel II Accord and liberalization of thee banking sector as stipulated by the WTO Accord on financial services will continue to consolidate and improve the quality of governance in the financial system (Randhawa, 2005).

Engaged businesses usually go beyond mere quarterly shareholder profitability expectations and aim at a longer-term sustainable value of an organization. The definition of

longer-term is itself conjectural since ‘future’ is a fickle concept and usually turns out differently than expected or forecasted. The devil lies in defining the details of what is understood by the “long term value”¹⁶ of an organization. Despite the growing importance of corporate governance practices, information in the areas of corporate ownership, structures, compositions, board practices, and compensation is still scarce (Mobius, 2003; Green, 2005). Furthermore, attempting to take a longer-term perspective is more often than not hindered by the financial community’s adamant and sometimes irrational overemphasis on the next quarterly financial results. Moreover, the lack of transparency and accountability not just in emerging markets but even up to Wall Street Institutions as indicated above has become a major issue of public debate.

What shareholders is the board of directors representing? Does the board need to jump to the fancies of short-term investors (i.e hedge funds) or does it represent the interests of long-term investors? In contrast to strategic investors, institutional money managers with mainly short-term perspectives increasingly control vast financial assets and start to determine the (short) time horizon of the corporate boardroom (Wellum 2007). What about long-term wealth creation or about efficient use of capital or about responsible stewardship? *What is sure though is that vision, moral competence and strong accountable and responsible engaged leadership embracing transparent global governance principles is a key characteristic to building a foundation on which businesses and governments may have a chance to withstand the tensions of an uncertain and often enduring future.*

The fiduciary duty of the board and its top management should analyze to what extent the organization is dwelled in or linked to a wider socio-economic environment which can and will need to be translated into a fiduciary care (Hart, 2007; Frances, 2008; Elkington *et al*, 2008). Such care of loyalty will likely result in some sort of corporate citizenship with the objectives to optimize resources that may lead to valuable products and services, wanted and needed by the “society” (Wallace *et al*, 2005) and thus in profitability. In a competitive global environment where it takes substantial time to gain a good reputation, it can be shattered by the click of a mouse. Hence, there is an enormous need for transparency, responsibility and accountability, underpinned by a sense of fairness by the leaders designing and implementing strategies.

Obviously, internal secretiveness should be distinguished from competitive advantages and innovative research that are closely guarded by the firm. Lack of transparency erodes trust and discourages collaboration. Despite legitimate moral and legal limits on disclosure, leaders should aspire to a policy of “no secrets” (Bennis *et al* 2008). However, the emergence of innovative internet and communication technology has lead to profound changes in our global culture wherein the ever-present “Internet-eye” scrutinizes any possible shady (corporate)

behavior that will be immediately blared in the openness of YouTube or FaceBook and the blogospheres alike. More than ever, trust and transparency are correlated into present corporate and public life. Transparency is no longer simply desirable; technologies and changed expectations have made it unavoidable. Google is not merely a search engine, it has become an instrument that crushes or elevates one's reputation. Genuine leaders of global corporations such as Johnson & Johnson or General Electric among a few number of other global firms¹⁷ encourage honest sharing of information endorsing good corporate governance that creates a reputation of candor underpinned by trust and respect. Moreover, such transparent policies supported by appropriate risk management may enable corporations to be better prepared to face a risky future, sometimes more fierce and unexpected than one could imagine.

Compliance with Institutional Entrenched Transparency

Institutionalization is the process through which components of formal structures become widely accepted to legitimize organizations, as both appropriate and necessary (Tilbert 1983: 25 in Zanotti 2008). Telling is US Supreme Court Justice Louis G. Brandeis eloquent statement that sunshine is the best disinfectant (Khurana 2008). The economic value of that sunshine is evident in the higher cost of capital in economies that lack it. Trust, moreover, underpins vibrant social and economic activities.

It is because of the asymmetry of information that there is market pressure to disclose relevant information through corporate governance principles and mechanisms to guarantee some market efficiency and fairness. A global corporate governance mechanism facilitates an efficient transfer of global capital that is constrained by a sound oversight framework and that promotes trust and efficiency in market transactions (Markarian 2007).

The legal or judicial regime and the role of political structure in a country affect the degree of transparency. It is expected that legal protection to outside investors' rights and enforcement of those rights vary around the world. Outside investors' demand for financial and governance transparency is expected to increase with a stronger protection of property rights as is the case in countries under common law tradition (La Porta et al 1999, 2000; Bushman *et al* 2004). The decentralized nature of English common law has the propensity to protect property rights of individuals more than in French civil law countries or even German or Scandinavian civic law traditions which fall in between the common law and French civic judicial system (La Porta *et al* 1999 & 2000). The propensity of policy makers to mandate and enforce transparent corporate reporting is expected to be much higher in countries where investors' rights are quite well protected. In the absence of a viable judicial system to enforce contracts, relationship-based

arrangements and private social capital enforcement mechanisms are sought that consequently relies less on public disclosed information (Dixit 2003; Verhezen 2008b). The lack of effective courts in a number of emerging countries with a civic law tradition in line with the French civic judicial history has an impact on the nature of contracts and business protection. Indeed, the stronger a regime's protection of individual rights, the more corporate transparency through greater voluntary disclosure can be expected (Bushman *et al* 2004).

Similarly, some distinct measures of the political economy such as the concentration of political power, the extent of state ownership of enterprise, the cost of entry imposed on start-up firms, the extent of state ownership of banks and the risk of expropriation by the state all have a dramatic effect on corporate transparency. Concretely, it is argued that powerful, centralized, closed governments will likely constrain financial development of disclosure to maintain power and capture wealth through politically connected interested groups. Such regimes may thwart financial development to maintain their economic advantage by suppressing competition. In other cases, economic institutions may not be sufficiently developed for private banks to play a crucial development role and therefore allow state ownership to take over that development role (Bushman *et al* 2004). Given the propensity for autocratic regimes to limit the freedom of the press, one could argue – but in our knowledge not empirically researched or proven yet – that corporate transparency could be suppressed under less open political regimes. Hence why the quest for more open or less opaque regimes.

Obviously, when the state is directly involved in the economy as is still the case in a number of emerging countries - and to an extent even in some developed countries – they may suppress firm-specific information to hide expropriation activities by politicians and their cronies. In some exceptional cases, benevolent regimes use its state ownership to directly govern and manage firms, obviating the need for public information (Bushman *et al* 2004; Shleifer & Vishny 1994). Moreover, politicians may exploit control over banks and regulatory policies through (1) preferential financing or (2) huge entry barriers or high entry costs on start-up firms. Such behavior aims to favor cronies in return for bribes, nepotism and political support. Restricting the flow of information to prevent public scrutiny of their business dealings with cronies is the logic manner to keep politicians protected from the light of transparency. In other words, politicians and governments can promulgate weak accounting and disclosure requirements or hardly enforce the existing disclosure requirements, or even use their influence over professional media to retard dissemination of firm-specific information in the economy (Bushman *et al* 2004). Richer autocratic countries seem to behave less nepotistic. A third factor used by politicians to exploit the power over firms is the potential threat of expropriation of firms' assets and profits. When

politicians exhibit a high propensity to expropriate wealth from firms – as is the case in a number of ASEAN member states – it creates the incentives for highly profitable firms to limit the disclosure and dissemination of firm-specific financial information to hide the existence of their profits from perceived corrupt government officials, while relatively less profitable but highly visible firms may have incentives to voluntarily disclose more firm-specific information to keep the too eager tax officials at bay. Paradoxically, governments with a propensity to expropriate - but also those with more benevolent objectives though tough tax rules - may mandate higher corporate transparency to aid them in identifying “profitable” assets more easily. Since competing forces are at play, no clear conceptual hypothesis or empirical evidence for one or the other reason of governments pushing for more or less disclosure requirements could be found (Buchman *et al* 2004). It should be noted that business transparency may be dangerous in a regulatory environment with poor quality and enforcement. In such situations, firms which disclose profits can still be subject to arbitrary government audits and expropriation by corrupt public officials. These arbitrary actions force firms to internalize those risks associated with corruption by maintaining a very closed non-transparent bookkeeping because accurate information is used by corrupt officials for increased levels of extortion (Root, 2001). Transparency policies are effective only when information becomes embedded in an action cycle of market participants, becoming an intrinsic part of the decision making routines of information users and disclosures (Weil *et al* 2006).

Therefore, global corporate governance principles are also interrelated with the notion of transparency through the implementation of practices based on integrity, accountability and responsibility. It should be recognized that since the corporate fiascos of Enron and WorldCom in the USA, Parmalat in Italy, the recent Madoff case (USA) and Raju’s Satyam case (India) and among others, some efforts have been made to implement stricter codes by individual organizations as indicated above, backed up by stricter legal oversight control on transparent disclosure and accountability by the Sarbanes-Oxley Act (2002). Indeed, business analysts have claimed murky accounting practices as the partial blame for a general loss of investor confidence that is harmful to the economy (Ancil *et al* 2004). It requires detailed reporting of off-balance sheet financing and special purpose entities and it increases penalties to executives for misreporting. However, SOA does not question the nature of corporate governance. As in traffic laws, the SOA and other codes of corporate governance provide a certain minimum protection, they do not guarantee excellent governance.

The increasing “transnational” – across and beyond national borders – demand for more accountability and transparency unquestionably highlights the need for compromises between the

Anglo-American outsider-dominated systems, which are comprised of dispersed equity shareholder positions and compliance driven systems and those of an Asian and to an extent European insider-dominated system, which are family or bank controlled equity shareholder positions respectively (even in the case of public companies) emphasizing long term vision and credibility within the community. In other words, a convergence regarding corporate governance would mean that a virtual merger would take place between the competitive market forces of the traditional Anglo-American systems of finance and control with the more long-term styles of management and investment prevalent in the traditional insider systems of corporate governance (Solomon *et al* 2004). The litmus test will be the practical and specific implementation of such governance principles in concrete contexts and subsidiaries, not just according to the letter but also especially to the spirit of these principles.

*Institutional transparency*¹⁸ is firmly entrenched with disclosure and dissemination of financial reporting, and should be distinguished from individual transparent leadership that is closely related to the notion of accountability. Both are necessary to create a better and more effective market system that optimizes resource allocation. Nonetheless, in spite of the generic principles of disclosure and accountability, one will need to emphasize the local context in which institutions operate.

We should note that even a company like Shell – known to be very compliance oriented – seems to get off track once in a while by for example misjudging the impact of some misreporting or inaccurate disclosure and subsequent reclassification of their oil reserves. Shell has been fined a total of USD 151 million (£ 83 million) for wrongly reporting 20% of its oil and gas resources; hardly a deterrent for a company which booked £ 2 billion net profit that same year (Mehra, 2005: 5). Empirical results indicate that the size and exchange effect of the company is positively associated with disclosure since public companies are more in the public eye which tends to make them exhibit greater disclosure than other smaller firms (Martinez 2008). And although some industries require even more disclosure because their activities are of important interest for environmental reasons for example, effective disclosure and transparency can be inadequate because incomplete. The real issue here is to find out the real intention and thus the perspective regarding the disclosure that is made. Moreover, an increasing pressure from NGOs and governments that are concerned with environmental and ethical decision making make big organizations more transparent by requesting – not regulatory yet in most countries – to publish triple bottom reports. Transparency is particularly important not just to shareholders but also to stakeholders since disclosing accurate and complete information is seen as part of the process of recognition of responsibility on the part of the organization for the external effects of its actions

and equally part of the process of transferring power to external stakeholders (Martinez 2008). Cases like Shell show, however, that increased disclosure, especially voluntary disclosure, does not guarantee that management is fully accountable to stakeholders and it may even hide important evidence of a less benevolent nature. Trust and confidence of sensitive but often asymmetric information availability is at stake in a more global and interdependent economy to guarantee some form of economic stability.

Both institutional and retail shareholders value intangible assets such as confidence in the personal strength and strategy of the company leadership have proven to be equally if not more important than the most recent financial results and the level of dividend payout (Uren 2003). We should indicate that superior market and individual outcomes are observed when information is withheld as compared to markets in which highly uncertain information is released. The Federal Reserve for example has more liberally disclosed information concerning their future plans in recent years. However, in a highly uncertain environment as we face with the current financial global crisis, better outcomes may actually result when information is withheld. Moreover, voluntary disclosure of managerial earnings forecasts could produce more uncertainty in asset markets (Ackert *et al* 2004). In other words, more transparency may sometimes cause more harm than good.

Transparency may reduce asymmetric information and hence lower the cost of trading or exchange while competitive costs may arise because disclosure provides potentially useful information to rivals. In other words, the main reason why corporations adhere to a high level of transparency is threefold: (1) improvements in information disclosure usually result in better recommendations by financial analysts and thus less risk (because of reduced information asymmetry), (2) improvements in stock liquidity also due to less information asymmetry, and (3) reduced capital costs because of lower information risk (Grüning 2007; Verrecchia 2001). Increased disclosure resulted in a higher share price, increased institutional ownership, a broader analysts following and increased stock liquidity as measured by narrower bid-ask spread (Uren 2003). In line with these expectations, 81% of executives and investors conclude that continuous disclosure regimes had added to the integrity of the market (Uren 2003).

People and organizations may try to take advantage of this openness, but that should not deter to stick to your principles of candor and honesty. A transparent company fosters a culture of openness and inclusion, and therefore is able to adapt to unexpected shifts in market conditions (Baum 2004). In other words, transparency builds trust, fosters good dialogue and communication, and encourages honest reporting and open and ethical business practices. Communicating the core values of an organization plays a major role in promoting a transparent

culture, and it is suggested that continuously doing so will help the efficiency of relationship building.

However, a caveat to this kind of “openness” should be added since directors would ensure that nothing that is price-sensitive would be released to the public other than through the formal corporate channel. A disciplined policy of continuous disclosure will reduce but not necessarily eliminate some surprise factor in the market and thus reduce some element uncertainty. Although prompt disclosure about news may generate greater volatility in the short term, it should produce a stronger market following and on average a higher share price over a longer period (Uren 2003). Well established markets do not like delayed bad news and therefore it is good to develop a reputation of being candid, forthcoming and open. Such a valuable and formidable asset may be difficult to measure, but it seems plausible to argue that companies with higher levels of disclosure achieve larger institutional shareholding and a lower cost of capital. Despite the positive effects of transparency that completeness of information in their annual report certainly appear to lower their cost of capital, it also seems to suggest that higher levels of disclosure in more timely reporting results in more volatile share prices, certain competitive disadvantages, bargaining disadvantages (Boesso 2003). Moreover, the risk of litigation in the USA and other Anglo-Saxon governance regimes suggests that companies with bad news are more than twice as likely to provide advance disclosure as are companies with good news.

Two interesting trends should be mentioned. There seems to be a growing demand for more (voluntary) disclosure, related to stakeholders’ interest such as ecological and ethical issues on the one hand, and a corporate desire to keep and guard sensitive information as “private” as possible on the other hand.

Guarding Corporate Information

One should ask whether the notion of transparency implies that all management decisions should be completely “disclosed” which may be contrary to the Asian intuition of keeping their cards close to their chest, or contrary to some Western management perception about revealing “sensitive” information. Nonetheless, it seems that transparency implies slightly different objectives. For private sector managers core objectives of transparency often include improving profitability, market share and reputation whereas for public officials, objectives of transparency may include gaining constituency support, legitimacy and trust (Weil *et al* 2006). Holding certain sensitive information close to one’s corporate chest does not preclude the importance of candor that brings along a higher level of trust and most often an increased productivity.

.The dissatisfaction with quarterly mandatory disclosure on the one hand and the demand for increased stakeholder reporting on the other hand have led to many initiatives in the world, encouraging companies to improve stakeholder reporting. Firstly, opponents of quarterly reporting question whether increasing the frequency of reporting will lead to an actual improvement of transparency, the pillar of good corporate governance. Such quarterly pressure rather misrepresents the financial position of the company and mislead investors and it promotes short-terminism in investing (Low, 2005). Secondly, company emphasis on stakeholder engagement and the need for management of intangibles were significant drivers to voluntary disclosure in Italian companies (and by extension to other continental European corporations) while in the case of the USA companies such relationship was not noted (Bouso 2003 & 2005). It could be argued that observed voluntary disclosure focuses on stakeholder relations and less driven by relevant internal processes such as governance and intangibles in an Anglo-Saxon context. Bouso's findings provide evidence to the fact that the corporate governance system of companies are extending beyond their traditional focus on investors and financial community to address diverse stakeholders. In other words, simply disclosing large volumes of information, it appears, is not sufficient. Rather, it is important to understand the perceived value of voluntary disclosure items in terms of the needs of individual stakeholders. Moreover, empirical evidence suggests that voluntary social reporting is not due to increased pressure on firms to be accountable but due to its success as a risk management tool (Hess, 2007; Porris, 2007; Esty *et al*, 2008). Current social reporting practices appear to be used by firms as a legitimating tool and insurance policy that attempts to change perceptions about a firm without necessary changing facts. Undoubtedly, there is a growing consensus of firms voluntarily disclosing social and environmental information when they are faced with some type of crisis that threatens their legitimacy (Hess 2007). Nonetheless, in spite of the good intentions, the apparent goal of this disclosure of non-financial data is to mainly to build their reputation through impression and public relations management.

Mandatory reporting can be seen as compliance with the letter and the spirit of the law while voluntary reporting could be interpreted as complying with the spirit of and intentions extend beyond the law. In order to make disclosure of non-financial information more effective and standardized, there are suggestions among researchers to turn voluntary reporting into mandatory reporting (Hess 2007). However, it should not be forgotten that the most important reasons for expanded disclosure of non-financial information according to executives was the opportunity to enhance the company's brand image and overall reputation, though meaningful stakeholder engagement will require comparable and thus standardized information. A fine line

needs to be walked between mandatory reporting and allowing competitive forces as in voluntary reporting to play out.

Obviously, not all corporate information could or should be shared with all stakeholders, competitors or the public at large. Organizations have the legitimate interest in holding and guarding certain information about innovations, original processes, secret recipes, corporate strategies, or sensible information about human capital from competitors. However, being sensible and reasonable to keep certain information from the outside world should not be used as an excuse for secrecy – the main characteristic to distinguish corruption from ethical corporate behavior (Ho, 2005; Verhezen, 2007).

An organization benefits from an open policy of “no secrets” where shared beliefs become the narratives and source of inspiration for those working there. Successful companies are able to get critical information to the right person at the right time and for the right reason (Bennis *et al* 2008). The reputation of the organization and the leadership is at stake when information that should be shown within the organization is kept too long secret, indicating and creating mistrust. When genuine leaders succeed to create organizations known for their reputation of candor and honesty, invariably they can draw on a strong good will which tends to weather scrutiny more easily in times of crisis.

Nevertheless, one could distinguish several motivations for secrecy within an organization (Uren 2003): it could preserve the golden goose as in the recipe of Coca Cola; it also could hide a dark secret of corruption, price-fixing cartels, illicit payments or other illegal and immoral corporate behavior; it could be a strategic advantage that functions as a deterring factor for potential entrants or it keeps too eager entrants at bay; it could reveal some tactical move as in negotiation techniques where not all information is shared to obtain the best solution; or secrecy may be paradoxically used to avoid harassment for example that temporarily could preserve its reputation. In that sense, preserving some kind of confidential information remains an intrinsic component of corporate management. Companies limit the circulation and disclosure of information in several ways.

There exists a tendency in organizations to call on the public relations department to spin unfavorable events. Most companies prefer to cover up their mistakes instead of learning from them. Often executive narcissism is the motive behind this form of sheer organizational hubris to conceal certain matters. And in most organizations, hidden ground rules govern what can be said and what cannot (Bennis *et al* 2008). Failing to hear critical information may prevent an organization to understand the real risk of certain activities. Herd effects or group-driven decisions – heralded as group cohesiveness and the pride in belonging – should be critically

reviewed since it may not always result in optimal decision-making as the brief analysis of the sub-prime mortgage crisis above seems to indicate. One should not avoid constructive conflict which may function as a dialectic process towards a more effective decision-making process. One could even argue that transparency could be seen as the evidence of an organization's moral health.

Executive compensation is one of the most important pieces of transparency because it is the catalyst for so many other related issues in an organization. Compensation packages can cause CEOs to cut corners or to do the wrong thing. If a CEO is grossly overpaid compared to company's performances, it can easily lead to pressure in other areas to manipulate financial reporting to make the company's number look better overall. Transparency by itself achieves little. Transparency needs to be marched by accountability on an institutional level and responsibility on an individual level. Some might argue that disclosure only becomes effective when managers are made accountable which should apply to any disclosure regulation in general. The UK has legislated to require listed company boards for example to report a detailed breakdown of the remuneration of executive and non-executive directors to shareholders for a vote at the annual general meeting (Uren 2005).

Although the Sarbanes-Oxley Act (2002) in the USA states that anyone involved in reporting a company's finances will be held responsible if it can be proven that he or she concealed the truth about the financial health of a publicly listed company. As will be argued in the third paragraph, good character – along good credentials – constitutes a transparent leader. But a leader needs to be able to fall back on institutionalized structures, as found in governance principles. However, have the recent regulations promulgated by SOA and the FASB adequately addressed the disclosure requirements of off-balance sheet and over-the-counter-derivatives, particularly where accounting and disclosure requirements may not track or measure economic realities of those products? Research has indicated that the accounting of intangible assets such as patents, unpatented results of R&D projects, proprietary software, ownership of non-utilized energy resources, brand names, reputation, the know how and skills of key personnel are at the heart of creating economic value but are not shown in reporting statements of the organization (Welch *et al*, 2006). Resource-based competitive advantage – next to the traditional agency theory - has become a top priority in management theory (Millar *et al* 2005, Hu & Verhezen 2009).

The board and its directors set the level of transparency or the amount and quality of disclosure. As indicated earlier, higher disclosure provides both benefits and costs. In other words better transparency is not free. Better transparency improves the board ability to monitor the activities of the CEO and the top management which also implies that the risk of being exposed

has logically increased as well. It seems that a “profit-maximizing” level of transparency requires to balance these two factors. Hermalin and Weisbach for example argue that there is an optimal level of transparency beyond which profits tend to decrease because managers will have to be paid higher salaries to compensate them for the increased career risk they face, and because greater transparency increases managerial incentives to engage in costly and counterproductive efforts to distort information (2007: 19). Indeed, better information disclosure up to that optimal point increases firm value. The unintended consequences of going beyond a certain optimal level of transparency will reduce the value of the firm because CEOs may be engaged in a so called exaggeration effect to increase particular signals, or he may try to obscure or deliberately direct certain information, or even conceal information. Moreover, it seems that if there were an increase in the quality of available information either due to more stringent reporting or better analysis by institutional investors or media, one expects that CEO salaries would increase and that the rate of CEO turnover would be much higher. The substantial increase of the 1990s is to a large extent attributable to the demand of more complex management, partially as result of the higher level of press scrutiny and investor activism (Hermalin 2007). In other words, rightfully pressing for more transparency is not without costs.

From a purely economic perspective, one should note that although greater transparency of information may mitigate uncertainty and thus risk about economic fundamentals, strategic uncertainty could be exacerbated which may result in inferior economic outcomes (Anctil *et al* 2004). Bank runs, currency attacks, loan foreclosures, and other panic-driven phenomena such as the current mortgage crisis are examples of the power of uncertainty. It almost functions as a self-fulfilling prophecy where creditors for example may prematurely foreclose a loan if it is believed that other creditors would act similarly because under increased uncertainty with the presence of multiple equilibria participants converge to the least risky solution, often resulting in an economic inefficient “equilibrium”. It seems that risk predominantly determines the selection of disclosure, rather than a “principle-minded” management which may or may not ignore the strategic uncertainty side effect created by more disclosure. In other words, although increased transparency provides scope for significantly increasing the wealth in the economy, this improvement is apparently neutralized and even wasted because strategic interdependence (a coordination problem) drives conformity to inferior strategies (Anctil *et al* 2004). The conclusion here is that unless the public disclosed information is sufficiently precise, it could create a risk that coordinated expectations may diverge from fundamentals, leading to suboptimal solutions or even “unreasonable” panic reactions as result of more ‘transparency’.

Analyzing these disclosure requirements leads us therefore to refine the notion of transparency. *Financial transparency* captures the intensity and timeliness of financial disclosures whereas *governance transparency* is defined as capturing the intensity of governance disclosures used by outside investors to hold officers and directors accountable. Empirical research indicates that financial transparency is significantly related to the country's political economy and not to the country's legal/judicial regime. Governance transparency, in contrast, seems to be stronger in countries with strong common law and only positively related to the presence of state-owned banks (Buchman *et al* 2004). One thus can stipulate that corporate transparency varies across countries: governance transparency is primarily related to the legal/judicial regime whereas financial transparency is primarily related to the political regime. Financial transparency is significantly higher where firms are larger which does not necessarily apply for governance transparency. High-quality financial reporting, the strong presence of financial analysts and institutional investors as well as well-developed media channels contribute to financial transparency, with the exception of insider-trading activities that is less easily suppressed by the above factors (Buchman *et al* 2004). A responsible and accountable board who functions as the link between operational executive management and the owners is more than an adviser, it functions as the supreme commander of the firm. A board who has a legal and moral obligation establishes the expectations of the company and demands evidence of achievement

RESPONSIBLE LEADERSHIP AND INTEGRITY *BEYOND* COMPLIANCE

The Sarbanes Oxley Act and new expected regulatory oversight with respect to contain global financial systemic risk may help to make organizations more transparent through more strict corporate governance practices. But internal or external legislation alone cannot make organizations more healthy or open. Only the virtuous character of those in power and all those making decisions that affect the production process of a good or service can make the ultimate difference between playing the game, continuously finding loopholes in the system or to go beyond what is legally expected. Candor and transparency becomes part of the organizational culture when corporate leaders agree that openness is valued and accountability will be rewarded accordingly. Accountability is more than being "called to account" or merely being appropriate or acting justifiably. Accountability also creates conditions for a dialogue through which the often tacit assumptions can be challenged and re-defined.

An Attitude of Individual Integrity based on Candor

In our networked global world, trust is everything. However fragile, trust along deeply shared cultural assumptions is one of the strongest glues binding people together in groups and organizations (Bennis *et al*, 2008). Responsible behavior by individuals and corporate behavior across national boundaries may be more easily instigated by voluntary and prerogative actions rather than coercion and mandatory or necessary laws. It is the non-executive skill in exercising independence of mind that is the key to effective board behavior. The openness of executives can become a source of confidence and trust for non-executives, and that in turn can encourage a mutually beneficial dialogue between management and board improving the company performances. Hence, trust and distrust in executives is rather to be understood as a continuous process of accountability. Where agency theory assumes self-interested opportunism as a given of human nature resulting in the presumed need for monitoring and control, a focus on accountability and integrity points to a more complex view of causality, in which top management motives are themselves conditioned by governance processes and relationship building.

Leaders need to show their responsibility with effective and (either political or corporate) independent oversight providing checks and balances to ensure that the process of providing sustainable value to its citizens or stakeholders, under the overall constraints of ethical values, thus enabling organizations and institutions not to get off track. Merely securing (minority shareholder) rights, verifying duties and performing authority check and balances are necessary actions to steer corporations away from disasters or may get them some corporate credibility or public relations kudos but are not sufficient steps to take on the daunting global challenges we are facing (Verhezen & Morse, 2009). Captains of governance need to embrace scalable entrepreneurial solutions that align and integrate profitability motives with societal and ecological goals, that encourage the transition to sustainable renewable resources and to stimulate investments in evolving and disseminating the necessary innovative technologies. It is not an exaggeration to say that the quality of management and leadership correlates with the quality of governance. Any business that attempts to pursue its corporate objectives at the expense of the society in which it operates will find its possible financial success to be “spiritually” illusory and most often very temporary. Hence, the overall importance of global governance principles that are translated in best global governance practices that may transform the corporation into a genuine global corporate citizen but that, nevertheless, remain a fallible work in process.

It should be acknowledged that well-performing boards would seek broad counsel where needed (Peng, 2005; Charan, 2005). Because power does not infer infallibility, failing to hear

critical information may undermine the firm's risk exposure. Some leaders may believe that vital lies preserve the surface harmony within the firm, but usually at a great cost setting in motion a certain dynamic which often afflicts rather than defends the longer term competitive position of the firm or public organization. It conforms to the conspiracy of moral silence. A vicious spiral of silence can easily undermine morale and productivity of the workforce under the helm of secretive or bullying leaders (Verhezen & Leis, 2007). Only productive candor as found in "constructive conflict" results in organizations which are characterized by a high level of transparency that indicates a level of moral health. In other words, transparent leadership helps to successfully and clearly communicate the firm's vision and objectives. Such an open and candid communication has become an effective tool to exert real (often informal) power to achieve superior performance.

The law is rarely the best guide for appropriate ethically and ecologically sound corporate behavior: it is often too little and invariably too late for many of the victims of corporate scandals or disasters. Legislation alone cannot make corporations responsible, open and healthy. That, however, does not contradict the importance of regulating bodies that monitor and minimize negative economic externalities and steer towards public and common goods, hence the importance of moral and visionary leadership at private and public levels. Harvard Business School ethicist Lynn Paine argues that an integrity strategy should be distinguished from mere complying with the law. A compliance strategy is a necessary but not sufficient approach to impress and inspire the workforce and the firm's executives (1994). The notion of transparency is applicable to both a strategy based on integrity – or *legitimacy* – as well as a compliance strategy – or *legality* -, though the intention differs in both cases. Only when there is a strong bond of trust, a company will be able to responsibly thrive over a longer period. When corporate governance focuses on justifying their management decisions and aiming at some level of *legitimacy* or even *legacy* in society over a longer period, it will need to apply the same principles of authority to make responsible and sustainable decisions and accountability for these decisions (Addendum Figure 2). Ultimately, the trust in leadership and confidence in corporations depend on the (moral) character and attitude of those who run the corporations and influence the newly emerging world order.

Trustworthiness and Leadership Responsibility

The discursive power of the different players, i.e. private corporations, governments and the public at large, is very vulnerable and far from secured in a global interdependent context. The question of legitimacy will continue to pop up and keep corporations and also governments

on their toes. Moreover, the political power of corporations has become contested in the context of the pros and cons of the globalization discourse (Fuchs 2007, Stiglitz, 2007, 2008). Global surveys currently reveal high levels of suspicion of and aversion to corporations.

The objective of corporations in today's world should be to underwrite broader "fundamental" principles, which may have some universal or global validity beyond cultures or ethno-centric perspectives that acknowledge and adhere to specific local practices. Ideally such discourse may even result in some form of "spirited sustainability" (Frances 2008). For instance, a good corporate citizen in China complying with and following international or global best governance principles and practices is unlikely to be perceived as evil in other business contexts.

Good governance is not characterized only by a set of rules and procedures. One reason that corporate challengers from emerging countries are particularly adept at creating and operating in such fluid organizations is their emphasis on trust, instead of mere procedures only, that functions as the glue for any business transaction. The right to know and the duty to disclose are grounded in trust. The transparency movement is a response to uncertainty and distrust.

Somehow, it is an *attitude* that brings a sense of responsibility into the realm of the corporate and political world. Warren Buffett would allegedly look for managers who are "hard working, smart, and honest". And the recent corporate scandals strongly indicate that the first two without the third can be disastrous (Wellum 2007). It is in the interest of corporations to be trusted and to be perceived as trustworthy which confirms that only an integrity-based strategy based on accountability and openness will succeed in the long term (Verhezen 2008a). Such an integrity-based strategy could turn the symbolic capital of integrity and responsibility into real economic profit. The principle of responsibility and accountability will need to be contextualized, institutionalized and translated into 'local' duties and rules. It is an *attitude* that is based on and inspired by the notion of *integrity* that encompasses accountability for one's actions, responsible behavior and a commitment to fair decisions in a transparent and thus open manner. Integrity displays a virtuous behavior within a complex reality that serves to link or dissolve disparate goals, values, emotions, aspects of self and periods in an individual's life. It is a virtue of balance that allows management of self-conflicts in a normative manner while taking into account that the self is dynamic and interdependent. Because transparency claims some truth value, the virtues of trustworthiness or sincerity and accurate reporting underpin the notion of accountability.

A certain level of openness is required to create trust between employees and management, between investors and management and between an organization and the public at large. Such openness, i.e. transparency on an institutional level and candor on an individual level, turns out to be necessary for the long term interest of all organizations. Trust and shared cultural

or organizational assumptions constitute the strongest glue binding people together in organizations. When leaders and top management trust their employees with due respect and speak with candor, those employees will respond with trust. Such an attitude is only possible when leaders walk their talk, when they are inspired and driven by integrity. Speaking truth to power implies to provide equal access to information to all, refrain from punishing who dare to speak out in organizations, refrain from rewarding mere loyalty and empower principled employees and management. Obviously, truthfulness occasionally clashes with the principle of loyalty. It is within the sphere of integrity that an appropriate balance between truthfulness and loyalty can be struck. Individual managers need to morally reflect upon the actions required, to be steadfast of keeping commitments in adversity, and to be unashamed about sticking to those principles (Carter 1996).

Integrity justifiably integrates an intelligible and defensible moral vision of one's character within a certain context, enabling a wise person to know how and when to adapt his moral principles and commitments when understanding a different reality asks him to do so. The "how" you do is sometimes more important than "what" you do, emphasizing an empathetic or virtuous attitude of integrity. Aligning a firm's commitment to moral values with a competitive strategy is a calling and an art, not [just] an engineering problem (Eisenstat 2008). Having a passionate purpose that aligns financial and non-financial objectives and unleashes energies will allow businesses to take sensible risks (Elkington *et al* 2008; Frances 2008). To build in best practices with regard to governance principles may have unexpected positive effects on our environments and even on our psyche. Visionary, purposeful and compassionate leaders function like alchemists who bring to the physical realm dreams and hopes that become attainable in a sensible business proposition.

The best way to guarantee to fulfill the expectations of customers and other important stakeholders alike is to build integrity within a corporate culture or to engrain integrity into the DNA of the company. Such a process may take painful years to achieve that objective, and one misstep can undermine all those efforts in a minute. Desiring to build a brand, an image, or the appearance of doing good is calculated and not genuine, that game could be revealed any day. The reaction from the customers and the public at large may be harsh. Today's consumers expect corporate responsibility from the companies they buy from (Baum 2004). Acting with integrity is doing the right thing regardless of the circumstances or consequences. A truly shared vision inspires an organization to hopefulness and success. Using vision and hope as the driving force rather than real or manufactured crisis, is a more powerful force. Leadership responsibility within organizations assumes a minimum form of transparency that informs shareholders and

stakeholders about the status of the organization without necessarily disclosing strategic sensitive information – unless legally required or socially strongly expected. The other important factor is individual candor or “accountability” incorporated in an attitude of integrity that is underpinning the overall principle of openness and honesty.

A culture of truthfulness and candor is characterized by virtues of humility, service to others and respect for people, exactly the opposite of sheer hubris which can be seen as at the root of the downfall of many leaders or managers falling in that trap. It is the board’s responsibility to reward a culture of candor. Hence the importance of independent directors who are usually better placed to provide disinterested and objective truth telling (Bennis *et al* 2008; Banks 2004; Clarke 2007). Aristotle suggested that the overall good of the group (i.e organization or state) takes moral precedence over the individual aspirations of persons in power.

CONCLUSION

Transparency invites accountability and drives dialogue between the corporation and the communities it serves. Transparency and candor are enabling corporate leaders and their organizations to respond to situations of crisis and to limit greed and ignorance in times of great uncertainty and increased levels of complexity. Indeed, in the face of a disappointing action, product or policy they are usually able to react responsibly in ways that maintain their clients’ trust and respect. Nonetheless, the daunting challenges current business leaders face – ranging from issues arisen of the Internet, of globalization, of creating and maintaining trust, of balancing shareholder and stakeholder interests, of visioning and executing sustainable strategies, and of acknowledging the need for broader vision and corporate leadership in society *beyond* a more “license to operate” – should be recognized and should be given time to be addressed in an appropriate and realistic manner. Moreover, the celebrity status of CEOs should give place to a more spirited stewardship role and transparent responsibility whereby board and CEO recognize their contribution and duty to long term organizational value while undertaking all institutional and personal endeavors to limit immoral greed and risky neglect that made the roaring corporate appropriation and irrational escalation of CEO compensation possible.

Moral hazard – widely recognized as one of the key causes of the current economic-financial crisis – should not be countered by more and complex regulatory systems. The boundaries of the game through governance principles should be pronounced and enforced more clearly and effectively without over-regulating the market game. The new line of defense should

be improving market competition through more transparency, not eliminating competition. It seems that there evolves a common understanding and agreement on some common ground of how good corporate governance principles should look like. ‘Global governance principles’ – in whatever way they are practically translated in their specific context – will help the overall performance of the organization, creating organizational value by taking societal and ethical values seriously. Those common ideals or global governance principles reflect an inward sense of vocation grounded in a commitment to peer sanctions and institutionalized monitoring. Failing to commit to those principles often results in mediocrity or worse, may lead to illegitimate and non-compliant behavior. This consensus-building around the governance principles of transparency and accountability is a dialectical process between firms (which increasingly are taking the lead) and governments offering a prospect of convergence for a better well-being and well-fare of their respective citizens, based on common overlapping norms of governance.

The notion of transparency aids corporations to gain legitimacy. Obviously, there are legitimate strategic and legal limits on disclosure, but ultimately, visionary leadership that emanates transparent responsibility will result in a legacy one can be proud of. Good disclosure and higher levels of transparency place demands on governance with the leadership pressed to show the responsibility to deal honestly with the public, rather than concealing mistakes and difficulties. Transparent leaders who embrace institutionalized disclosure linked to improved risk management systems and individual candor based on integrity-based strategies will assess business strategies and make thoughtful and responsible choices amidst an increasingly complex world. Transparency has provided a vehicle for new and imaginative research methods to improve practice and inform the public. Moreover, wise leaders find ways to get information in its raw form, to get unbiased information. Transparency – if well managed and well tuned - could be seen as a useful tool to improve the communication and relationship between management and other stakeholders on the one hand, and to reduce reputation and financial risk on the other hand.

The building blocks of disclosure and integrity function as the pillars of transparent responsibility and thus of good corporate governance, possibly steering organizations away from future disasters. Institutionalized entrenched transparency and an attitude of individual integrity underpinning accountability by top management can be perceived as one of the main pillars constituting “best governance practices”. The values of virtuous and accountable leadership that inspire and drive an organization is often expressed in institutionalized transparency and individual candor where everyone is empowered to speak the truth in a respectful manner. Within such trust-enabling environment companies rise to the occasion to embrace uncertainty and to take full advantage of particular business opportunities

Actual effectiveness of a board committed to transparent leadership implies a culture of candor and openness, underpinned by a constructive dialogue in an environment of trust and mutual respect. Visionary and transparent leadership, encompassing efficient compliance and reporting requirements on the one hand and compassionate integrity-strategies on the other hand, function like the sails that determine a favorable outcome. In other words, not greed, ignorance or neglect but institutionalized transparency and individual candor are the compasses that guide boards and top management to steer the ship away from murky waters. If one is aware that not the wind, but the sails determine the course, one will be to avoid regret and to overcome fear.

Appendix: Transparency, Integrity and Responsibility

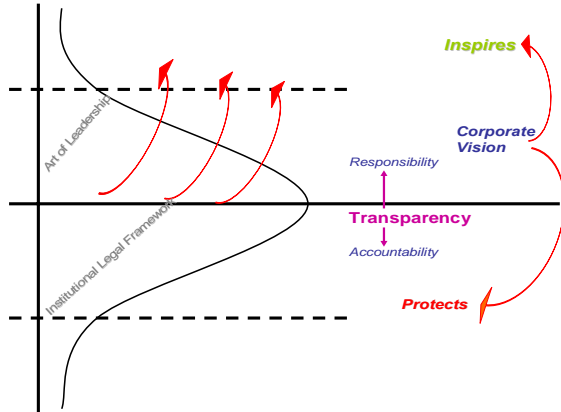


Figure 1: Transparency: accountability and responsibility

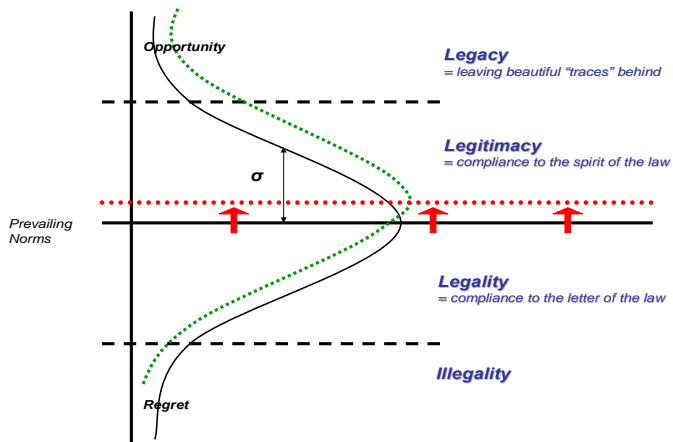


Figure 2: Legality versus Legitimacy and Legacy

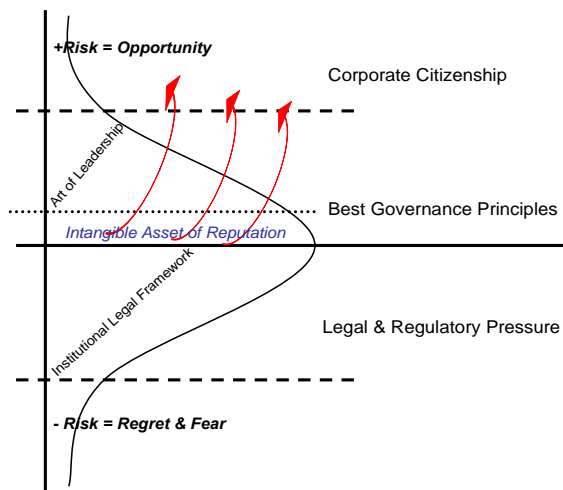


Figure 3: Legal Requirements versus Best Governance Principles

NOTES

¹ The notion of Transparency is one of the seven criteria that are often used to determine the level of corporate governance in countries. CLSA for example has developed those 7 criteria to apply to Southeast Asia. (1) *Discipline* concerns the management's commitment to emphasize shareholder value and financial discipline; (2) *Transparency* is the ability of outsiders to access the true position of a company; (3) *Independence* refers to the Board of Directors' independence of controlling shareholders and senior management; (4) *Accountability* equals the account of management to the Board of Directors; (5) *Responsibility* is the effectiveness of the Board of Directors to take necessary measures in case of mismanagement; (6) *Fairness* is the treatment of minority shareholders reviewed from majority shareholders and management; (7) *Social Awareness* concerns the company's emphasis on ethical and social corporate responsible behaviour.

² This brief analysis of the Global Mortgage crisis is based on a Lecture "Causes and Consequences of the Current Financial Turbulence" by Professor Raghuram Rajan, Professor Finance at the Graduate School of Business of Chicago, at the University of Melbourne on 5 November 2008, and a Lecture "Could Good Governance have prevented the current global Mortgage Meltdown?" by Dr. Peter Verhezen at the University of Fudan on 17 October 2008. The analysis is meant to be indicative rather than exhaustive.

³ See Shiller (2008), page 46: "Speculative price increases encourage genuine economic optimism. Hence more spending, hence greater economic growth, hence yet more optimism, hence further bidding up of prices. Most persons may be forgiven for not seeing that the sense of economic prosperity that usually attends a major speculative bubble is actually caused by the bubble itself and not by economic fundamentals."

⁴ Although the current financial crisis has resulted in a staggering USD 6 to 9 billion meltdown of capitalized funds, the percentage lost in terms of GDP is relatively much less compared to the Asian countries during the 1997-2002 crisis.

⁵ See Randhawa (2005): 64-67. The Basel Accord on capital adequacy seeks to establish uniform risk measurement guidelines for international banks. Adherence to the accord aims to reduce the increasing level of systemic risk and the associated threat of contagion effects. Hence, most major economies, including the ASEAN countries, have all committed to adhere to the guidelines prescribed by the agreement, albeit with varying deadlines. The accord rests on three pillars: minimum capital requirements, supervisory oversight, and market discipline based on risk-based disclosure. The most serious challenge Asian banks face is in the implementation of Pillar Three of the Accord. The disclosure regime prevailing in the developing economies of Southeast Asia is grossly inadequate for this purpose. Improvements in transparency will be necessary to mobilize funds from the public. In the absence of well functioning capital markets, prospects to effectively use these risk instruments as monitoring devices will remain limited.

⁶ The OECD Principles:

- (1) Rights of shareholders refer to the basic rights of ownership and information.
- (2) Equitable treatment of shareholders implies equality per shareholding of minority and foreign shareholders.
- (3) The role of stakeholders recognizes their rights and encourages cooperation and information-sharing.
- (4) Disclosure and Transparency rules provide timely, accurate and cost-efficient information on all matters regarding the corporation, including financial and operating results, change of ownership, voting rights, key executives / board members and their remuneration, governance structures, and policies and issues regarding employees.
- (5) Responsibilities of the Board detail their accountability to the company and shareholders and their role in ensuring compliance with laws and regulations and the integrity of the financial reporting process.

⁷ See Mobius (2003). The Delaware Supreme Court (Delaware Corporate Litigation Reporter, 2002) stated that loyalty "as a public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of corporate officers and directors, peremptorily or inexorably, the most scrupulous observance of his duty". In fact, one can assume that there shall no conflict between duty and self-interest according to this ruling.

⁸ See Dimma (2002): 166. Even though the Delaware jurisdiction – which rules over a great number of Fortune 500 Multinational Corporations - has historically speaking always strongly favoured shareholder rights in its strict legal interpretation, the state Supreme Court has also recognized two important principles in the classic Time-Warner case: “(a) the fiduciary duty to manage a corporate enterprise includes the selection of a time-frame for meeting corporate goals; (b) Directors must chart a course for a corporation which is in its best interests without regard to a fixed investment horizon.” In other words, these two principles now considered as the contemporary mainstream view in the Anglo-American governance framework, it may be appropriate to deviate from short-term shareholder interests in favour of longer-term corporate interests if the interest is fully compatible with longer-term shareholder interests.

⁹ See Markarian (2007): 298. The main issues regarding good corporate governance concern that (1) a majority of non-executive board members have to be independent and perceived as professional while the board itself should be characterized by diversity; (2) several committees should be established within the board (i.e. remuneration, auditing, nomination); (3) remuneration for executives should be decided only by non-executive directors; (4) the majority of the audit committee has to be independent and non-executive; (5) there is a preference of a separation of chairman and CEO function; (6) it has been suggested that there is a maximum duration for non-executive directors who should be evaluated on a regular basis, (7) attention should be given to social and environmental issues.

¹⁰ We here refer to the very useful and well-organized criteria used by CalPERS who manages more than USD 160 billion to invest in a variety of international firms.

The first main factor investing in a firm is related to the **country risk** in which that firm is operational: 1. *Political Stability* (a. Civil liberties; b. Independent judiciary and legal protection; c. Political risk); 2. *Transparency* (a. Freedom of press; b. Accounting standards; c. Monetary and fiscal transparency; d. Stock exchange listing requirements); 3. *Productive Labor Practices* (a. ILO ratification; b. The quality of enabling legislation to explicitly protect or prohibit the rights described in the ILO Convention; c. The institutional capacity of governmental administrative bodies to enforce labor law at the national, regional and local level; d. Effectiveness of monitoring and enforcement of laws in the ILO Convention areas).

A second criteria to establish an investment will require an in-debt analysis of the **market risk**: 1. *Market Liquidity and Volatility* (a. Market capitalization, the overall size of the country’s stock market; b. Change in market capitalization, the growth of the country’s stock market over the last five years; c. Average monthly trading volume relative to the size of the market; d. Growth in listed companies over the last five years; e. Market volatility as measured by standard deviation over the last five years attributable to both currency volatility and local market volatility; d. Return/risk ratio in each market); 2. *Market Regulation / Legal system / Investor Protection* (a. Adequacy of financial regulation; b. Bankruptcy and creditors’ rights; c. Shareholders’ rights); 3. *Capital Market Openness* (a. Trade policy, measuring the degree to which there is oppressive government interference to free trade; b. Foreign investment, measuring governmental barriers to the free flow of capital from foreign sources including unequal treatment of foreigners and locals under the law; c. Banking and finance, measuring government control of banks and financial institutions and allocation of credit and the degree of freedom that financial institutions have to offer all types of financial services, securities, and insurance policies; d. Stock market foreign ownership restrictions; e. Settlement Proficiency = the country’s trading and settlement practices to determine the degree of automation and the success of the market settling transactions in a timely, efficient manner; f. Transaction Costs = the costs associated with trading in a particular market and includes stamp taxes and duties, amount of dividend and income taxed, and capital gains taxes).

Finally, one will need to analyze the **specific risk factors of a firm** which are often related to their specific organizational corporate governance principles or lack of them and the quality of the top management who is supposedly developing strategies and economic fundamentals which are sensible for the creation of long-term value of the firm.

¹¹ See Green (2005) and Neoh (2003). The present state of the Chinese capital markets is the result of “short-termism” in managerial attitudes that has lead to short-term speculative investment horizons which in fact is contradictory to the Confucian values of harmonious continuity in family-owned businesses. Nevertheless, most listed companies in China are still state-owned which implies that political rather than economic objectives play an important role. The Code of Corporate Governance for Listed Companies in China (2002), which was implemented by the China Securities Regulatory Commission, is a good step in the right direction that seeks to make listed companies in China more attractive to investors. Appropriate

good governance mechanisms would be highly recommendable to improve the financial performances of those listed Chinese companies.

¹² See Cornelius (2003) and CalPERS criteria *among others*. From the different sources, we can summarize that most global investors believe that good corporate governance standards imply:

- A significant percentage of outside or independent directors on the board
- These independent directors are truly independent of the management
- The board members and directors have significant shareholdings when representing fund managers and institutional investors
- A material proportion of the directors' compensation is related to these stockholders
- Mechanisms for formal evaluation of directors and board members
- The board is very responsive to investors' questions on governance issues

¹³ See Uslaner (2002) and Brenkert (1998). Generalized trusters presume that most people they meet share their values whereas particularistic trusters view the outside world as a threatening place over which they have little control.

¹⁴ See Kurtzman (2004 and 2007). The opacity index analyzes five areas of concern: corruption in business and government, ineffectiveness of its legal system, negative aspects of its economic policy, inadequacy of its accounting and governance practices, and detrimental aspects of its regulatory structures.

¹⁵ In these times of knowledge-based organizations, one should recognize that the critical success factor has become the human "asset", the knowledgeable workers. The organization is at risk if its culture deviates too much from the values of its people. In other words, greater priority needs to be given to good corporate citizenship in all senses of the word, which makes the organization attractive to enlightened knowledge workers and other stakeholders, especially if the organization is responsive to pressing humanitarian and environmental issues.

¹⁶ Should long-term value include externalized costs such as corporate polluting practices for example? Changing the organizational culture of a firm to one that adheres to a broader definition of value and committed to transparency is not an easy task, but some firms – on a multinational as well as a national level – are increasingly taking up the challenge and achieving partial success; *caveat* the continuing global ecological degradation, increasing income inequality and poverty gap and the insensible and often greedy and materialistic trend of irrational consumerism promoted and advertised by global corporations. Moreover, it is within a regulatory and legal institutional framework that governments have a vital role to play in the creation of strong vibrant markets that embrace economic and social values.

¹⁷ See <http://www.gmiratings.com>; Green (2005); and Kurtzman *et al* (2004). Governance Metrics International (GMI) maintains ratings on the corporate governance practices of over 3200 global companies, evaluating them based on (1) board accountability and independency of directors, (2) financial disclosures and internal control, (3) executive compensation, (4) shareholder rights and minority rights, (5) ownership base, ownership concentration and takeover provisions, and (6) corporate behavior and responsibility. It should be stressed that social corporate responsibility and its appropriate behavior is only one of the six variable used to analyze and evaluate those global multinational corporations. Such metrics are used not only by institutional investors, but also by credit rating agencies, lenders, and even regulators. In 2004-2005, GRM announced that about 34 companies, from which 27 were US based, received a perfect score of "10.0". To name a few of those well governed companies in alphabetical order: 3M Company, BCE Inc, BP plc (UK), CITI Group Inc, Colgate-Palmolive Company, Eastman Kodak Company, General Electric Co, General Motors Corp, Johnson Controls, Lockheed Martin Corp, Mattel Inc, Nexen (Canada), PepsiCo Inc, The Dow Chemical Company, P&G, Vodafone Group (UK), Westpac Banking Corp (Australia). However, such a high score in the yearly beauty contest does not guarantee against missteps or crises as Mattel recently experienced. And companies, not exactly known for their CSR commitments, such as the Dow Chemical Company (who acquired Union Carbide) made it to the top list, nevertheless. The ratings remain highly subjective but give an indication of the importance of corporate governance. If one compares such corporate governance ratings with the opacity index rating – developed by Kurtzman *et al* - one finds some consistence between corporate and generic governance ratings. However, most small and medium-sized companies are, unfortunately, excluded from these contests and surveys because of a lack of information.

¹⁸ See Millar *et al* (2005): 166: "Institutional transparency is the extent to which there is publicly available clear, accurate information, formal and informal, covering accepted practices related to capital markets, including the legal and judicial system, the government's macroeconomic and fiscal policies, accounting

norms and practices (including corporate governance and the release of information), ethics, corruption, and regulations, customs and habits compatible with the norms of society.”

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