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Abstract

Swift action must be taken to remedy managerial situations and actions that are not in accordance with the best interests of the company. This requires solutions that take the company forward – every moment, every decision, every day – without fail – no excuses.

Keywords

corporate corruption, best interests, directors duties, corporate decisions, corporate decision making, corporate inefficiency, enron failure, corporate transparency

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CORPORATE DECISION-MAKING, CORPORATE COLLAPSE AND INEFFICIENCY

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Swift action must be taken to remedy managerial situations and actions that are not in accordance with the best interests of the company. This requires solutions that take the company forward – every moment, every decision, every day – without fail – no excuses.

Companies are a nexus of decisions.¹ The quantum of each day's decision making either moves the company forward in its best interests, backwards from its best interests or leaves the company neutral in relation to its best interests.²

Corruption is 'something spoiled'.³ As a result, any imperfect decision that is not in the best interests of the company is a corrupt decision. Any one decision could be the first decision down the path to corporate collapse. All corporate collapses begin with an ethical lapse in one decision – often followed by attempts to cover up the initial poor decision.⁴ Each corrupt decision that does not lead to corporate collapse is inefficient in relation to the optimum performance of the business.

Decisions are made by people who are imperfect, prone to irrational, emotional or self-interested decision-making all of which may not be in the best interests of the company.⁵ People are inherently flawed, therefore corrupt decision-making is the norm and not the exception.⁶

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¹ Chia R, (2000) 7 'Discourse Analysis as Organisational Analysis' *Organisation* 513-18.

² Ford JD, 'Organisational Change as Shifting Conversations' *Journal of Organisational Change Management*, Vol 12, No 6 1999 480-500. See also Pfeffer J, *Managing with Power* (Boston Harvard Business School Press 1992).

³ Caiden GE, (2003) 'The burden on our backs: corruption in Latin America' VIII Congreso Internacional del CLAD sobre la Reforma del Estado y de la Administracion Publica, Panama Oct at 23. Also Buchan supports a Machiavellian view of corruption (which can be applicable in the context of companies) as 'first a loss of discipline of virtue, and second, as a preponderance of private interests over the public interest.' Buchan B, 'The moral physics of the body politic: Changing contours of corruption in Western political thought'. A paper presented to the *Australasian Political Studies Association Conference*, University of Adelaide 29 September – 1 October 2004 at 11.

⁴ 'Unethical business decisions may stem not from the traditionally assumed trade off between ethics and profits ... but from psychological tendencies that foster poor decision making' Goodpaster KE, *Conscience and Corporate Culture* (Malden MA Blackwell 2007) 75. See also Jennings M, *The Seven Signs of Ethical Collapse* (New York St Martin's Press 2006).

⁵ Ibid. See also Caiden, above n 3.

All decisions are confined to bounded rationality.⁷ Good decision-making takes more effort and is also subjected to internal and external ‘influences’ that impact the decisions, over and above those variables that relate to the ‘human condition’.⁸ A good decision in one ‘moment’ may not be a good decision in the following ‘moment’ due to changing variables. Therefore, constant vigilance is required.⁹

Successful companies in the long term are those that make better decisions than their competitors.¹⁰ No company is immune to corrupt decision-making.¹¹ In competitive markets, optimum performance is relative, not absolute, and given the complexities involved in good decision-making, complete efficiency is highly unlikely. All companies have room to improve. This is a different argument from those touting the triple bottom line and integrated reporting solution to governance issues.¹² Whilst these approaches have some merit and may reduce some inefficiencies, they are unlikely to prevent corporate collapse, for the same reasons financial reporting fails.¹³

Optimal decision making is complex and a multi-faceted approach to ‘decision making governance’ is required that includes a combination of targeted regulation, internal values, ethically based decision-making, strong leaders with moral courage,¹⁴ rigorous selection processes

⁶ Ibid.

⁷ See Selten R, ‘What is Bounded Rationality?’ SFB Discussion Paper B-454. A paper prepared for the Dahlem Conference May 1999.

⁸ ‘Rational decision making is an ideal which, even if not empirically descriptive, is to be kept for both external and internal system maintenance at all costs. Thus it is in the interests of all who share the belief in the myth of rational choice that decisions appear to be made rationally rather than to be based on power and politics.... Discerning power by observing its consequences, therefore, requires access to decision outcomes.’ Pfeffer J, *Power in Organisations* (Cambridge M A Ballinger Publishing 1981) 50.

⁹ ‘[N]o generally successful corporate governance system, either past or present, can exist, without three ingredients: first, knowledgeable and committed long-term owners; second, management that is focused on and rewarded for long-term performance; finally, those managements must be held properly accountable to the vision that has been previously agreed.’ Bain N and Band D, *Winning Ways Through Corporate Governance* (London, Macmillan, 1996) 191.

¹⁰ Collins states that being able to effectively adopt the ‘Stockdale Paradox’ will dramatically increase the odds of making a series of good decisions. This paradox is outlined as the ability to ‘retain faith that you will prevail in the end and you must also confront the most brutal facts of your current reality.’ See Collins J, *Good to Great* (Random House 2001) 86-7.

¹¹ ‘[C]orruption is contagious, and the more widespread it becomes, the more it infects and confuses those who want to do the right thing.’ Brontas PP, *Boardroom Excellence* (San Francisco Jossey-Bass 2004) 7. See also Jennings, above n 4.

¹² See KPMG, ‘The Future of Corporate Reporting: Towards a Common Vision’ 2013.

¹³ With reference to the HIIH Commission: ‘The Commission was not concerned with the content of a corporate governance model but rather the culture of the organisation to which it attaches. Most telling was the observation that HIIH’s corporate governance procedures would probably have measured up well, as a paper exercise, against most codes studied.’ Maltas JD, ‘The demise of HIIH: What part did failed corporate governance policies play’ Working Paper (No 05.02) Working Paper Series School of Business Law, Curtin University of Technology Perth WA at 72.

¹⁴ Ludwig and Longenecker’s view that there is a ready willingness to abandon personal principle – not so much a matter of ethics or of virtue but a lack of fortitude and courage. They suggest that this is more often the case in the wake of success than in the face of competitive pressure. Ludwig DC and

for hiring staff, zero tolerance for poor decision-making,¹⁵ flat structures dominated by democratic processes¹⁶ and real empowerment to challenge decision-making.¹⁷

In agency theory, the agent's fiduciary duties are relied upon to mitigate against the propensity of the agent to engage in self-dealing.¹⁸ In the corporate world, fiduciary duties are enshrined in law and bolstered with additional provisions in an attempt to ensure that directors (in particular) make decisions in the best interests of the company.¹⁹ This is juxtaposed against the backdrop of maximising profits and returns for shareholders which is invariably interpreted within the context of the 'short-term'.²⁰

Given the moment-by-moment nature of decision making, it is easy to see why traditional approaches to regulation fail when competing to be 'front of mind' when directors are faced with the heady cocktail of the immediate pressures of business mixed with the lure of self-interest.²¹

This is also why reliance on reporting is insufficient.²² The advent of continuous disclosure and an increased emphasis on materiality go some way to creating a better environment for good decision-making.²³ These approaches make good business sense and companies ought to adhere

Longenecker CO, 'The Bathsheba Syndrome: the ethical failure of successful leaders' (1993) 12 *Journal of Business Ethics* 265, 267-8.

¹⁵ This is not the same as making the best decision possible in the circumstances that later is mistaken or leads to a failure. Failure as a result of good decision-making is not the same as a poor-decision. A 'poor-decision' in this context is one that at the time it was made, was not genuinely in the best interests of the business (including those that are stated as such but on deeper searching, are not.)

¹⁶ Whilst the hierarchical nature of the military is often cited as an example of how effective and efficient pyramid power structures can be, however, the military is not a company, does not have the same agency issues (although they do have different ones) and is not competing in a marketplace.

¹⁷ Pyramids emphasize power, promote insecurity, distort communications, hobble interaction and make it very difficult for the people who plan and the people who execute to move in the same direction. So Semco designed an organisational circle.' See Semler R, 'Managing without Managers' *Harvard Business Review* September-October 1989 at 4.

¹⁸ See GE Dal Pont, *The Law of Agency* (Butterworths 2001) 219.

¹⁹ See the *Corporations Act 2001* (Cth).

²⁰ '[T]he sternest critics of the Anglo-American model of corporate governance argue that it is fundamentally flawed by an excessive concern with the short term, which is itself a consequence of capital market failure.' Keasey K, Thompson S and Wright M, *Corporate Governance* (New York, Oxford University Press 1997) 5.

²¹ 'It is also important to recognise the highly situational character of quests for power and influence. In the way that change processes are often shaped by features of the content and context in and around the change, so also are political processes in organisations. Most individuals are limited to certain spheres or domains of influence. Power displayed on one occasion may not be transferable to other settings. Because power is inherently situational, it is dynamic and potentially unstable.' Pettigrew A and McNulty T, 'Sources and uses of power in the boardroom' in Tricker RI, *Corporate Governance* (Aldershot, Dartmouth Publishing, 2000) at 202. Also, a person is not 'powerful' or 'powerless' in general, but only with respect to other social actors in specific social relationship.' Above n 8 at 3.

²² See above n 13.

²³ Here I am referring to the concept of having discussions with stakeholders about what is materially important to them. This does not mean that companies ought to base their decisions solely on these discussions but that they may help create more informed decisions. As The ACCA report outlines in their study: 'in sustainability reporting, materiality has been found to be a very complex concept' ACCA

to them anyway, independent of any requirement. The inclusion of stakeholder materiality and continuous disclosure in the governance framework of the business cannot, however, substitute for good-decision making.²⁴

Trust is the ultimate currency of success in market driven economies and trust is enhanced by reliable information from noteworthy sources.²⁵ Companies that take proactive approaches to engendering trust through increased transparency of their decision-making processes will gain a competitive advantage. This does not necessarily require an external framework of reporting or accounting processes that cost companies time and money. This does not mean companies should not report, only that reporting alone is not a substitute for good decision-making.²⁶

Consistent and reliable good-decision making will take companies further faster and each company is able to create innovative ways of demonstrating how and why they can be trusted with or without external assistance. Those that fail to take up this challenge will be left behind by those that do.

Corporate collapse starts with the board and relates directly to the players involved. Imagine HIIH²⁷ without Ray Williams or Enron without Jeffrey Skilling or Kenneth Lay.²⁸ The ‘elephant in the room’ is most often ignored; no one challenges the ‘lion’ and if someone does, they are soon shown the door.²⁹ This phenomenon is not restricted to the boardroom. All companies suffer inefficiencies due to ‘management politics’. In many cases companies become de-facto fiefdoms and decisions revolve around information that feeds the egos and belief systems of management – further restricting bounded rationality.³⁰

‘Integrated reporting: the influence of King III on social, ethical and environmental reporting’ London 2012 at 51.

²⁴ ‘Although the concept of an integrated report should embed sustainability reporting into the heart of the primary reporting vehicle, the annual report, this does not necessarily imply that the reporting will fulfil its potential for transforming corporate behaviour or will not produce merely empty rhetoric’. ACCA ‘Reporting pre-and post-King III: what’s the difference?’ August 2012.

²⁵ See Andreoni J, ‘Trust, Reciprocity and Contract Enforcement: Experiments on Satisfaction Guaranteed’ University of Wisconsin unpublished paper 2005.

²⁶ One option might be to post all board minutes online for the decision-making processes to be totally transparent. In this scenario a caveat would be created for specific confidential material that was deemed to be ‘materially confidential’ by means of declared framework outlined for this purpose. The practice of publishing board minutes is not established with some entities like the Arizona State Board of Pharmacy.

²⁷ Clarke F, Dean G and Oliver K, *Corporate Collapse* (Cambridge, Cambridge University Press 2003) at 222.

²⁸ ‘In the worst of all cases, toxic leaders fall under the spell of their own grand illusions and believe that they can [deliver]. Jeffery Skilling, former CEO of Enron, predicting an astronomical spike in the next year’s stock price just as the company was imploding, is but one classic example.’ Lipman-Bluman J, ‘The allure of toxic leaders: Why followers rarely escape their clutches’ (2005) January/ February *Ivey Business Journal* at 5. This is not to suggest that corporate collapse is the consequence of a few ‘bad apples’. As Collins states: ‘Every institution is vulnerable, no matter how great.... Anyone can fall and most eventually do.’ Collins J, *How the Mighty Fall* (HarperCollins 2009) 8.

²⁹ This is in stark contrast to highly successful companies and teams that surround themselves with best people in each role and adopt honesty, accountability and shared values as the context within which they make decisions. See Mazany P, *TeamThink* (Auckland, SmartSims.com 1995).

³⁰ ‘CEOs who fall prey to this belief [that they and their companies dominate their environment] suffer from the illusion of personal pre-eminence ... as far as they are concerned, everyone else in the

Employees work to earn a living and therefore rely on their salaries. They make decisions based on their self-interest of being able to maintain their lifestyle rather than what is best for the company. Likewise, managers jockey to impress the CEO and ensure that any potential threats to their positions (or those they are eyeing off) are kept in their place. This reflects their own self-interest, not the best interests of the company. These players depict the hyena of the animal world. They often avoid the heavy lifting and come in to ‘mop up’ when the lion is done.

The lion relies on the hyena because the lion knows the hyena is unlikely to challenge him/her (and if the hyena was to challenge they would most often lose). The hyena for the most part does not mind, as his/her interests are served by letting the lion do what s/he does best. This is a marriage of self-interest at the expense of the company.³¹

Like the animal world, both the lion and the hyena are adept at playing this game and it is often not until the company has collapsed that the true nature of the self-indulgent decision-making is revealed.³² By which time authorities and creditors are chasing the lions and the hyenas are long gone.

Good corporate governance therefore needs to facilitate the identification of players who are not making decisions in the best interests of the company. This information needs to be readily available to shareholders and stakeholders. This is not easy because adept players are those that can find ways to ‘spin’ the truth and convince others (and possibly themselves) that they are doing the right thing by the company.³³ Therefore, mechanisms are required to identify and circumvent ‘spin’.³⁴ Those making the best decisions possible have nothing to hide. Collins identified this in his conclusions about the senior executives who were able to make good companies great.³⁵

Executives with the discipline and capacity to deliver on good decision-making in the best interests of the company, within the context of the Stockdale paradox, are what companies

company is there to execute their personal vision for the company.’ Finkelstein S ‘The seven habits of spectacularly unsuccessful executives’ (2004) January/February *Ivey Business Journal* 2.

³¹ ‘What’s best for the organisation plays second fiddle to personal aggrandizement ... executives and others at Salomon Brothers and Enron lost sight of what was in the best interest of the organisation because they were in powerful positions and the decision-making process was driven by a politically dominated culture that saw numerous individuals’ vested interest in particular outcomes supersede the right thing to do for the larger organisation’: Sims RR, *Ethics and Corporate Social Responsibility: Why Giants Fall* (Westport C T Praeger 2003) 248.

³² Regulators are often the last to learn about the true nature of the business.

³³ ‘[G]ood governance can be found in human and social factors rather than structural factors and what distinguishes the best boards is that they are robust and effective social systems.’ Huse M, *Boards, Governance and Value Creation* (New York Cambridge University Press 2007) 235.

³⁴ ‘This is particularly difficult as these players are expert manipulators and highly skilled at deception often using charm and ‘corporate speak’ to disguise their true nature. They refer to company and higher values, corporate responsibility and making ‘balanced decisions’ whilst encouraging others to see them as ‘Mr Integrity’ to shield their true nature and intentions. As stated by Babiak and Hare: ‘without prolonged and perceptive interactions with these individuals, we typically are not sure what this character is, particularly when it is obscured by charming physically and socially attractive exterior... it is not uncommon for well trained researchers in this field of study to be fooled and manipulated by *known* psychopaths they have just met.’ Babiak P and Hare R, *Snakes in Suits* (HarperCollins 2006) 66-67.

³⁵ See n 10.

require.³⁶ These executives are not lions or hyenas. Indeed, lions and hyenas have no place in successful companies because their motivations are not aligned with the best interests of the company.³⁷

The problem is not resolved by simply identifying the executives required, because all executives are human. Situations change constantly, pressure mounts, the lure of self-interest is a constant friend and the incentives for short-term returns are never-ending.

A robust and comprehensive system of constant vigilance that shines a light on decision-making in the best interests of the company in every decision is required. This takes a systematic approach to embedding values that are lived and breathed on a moment-by-moment basis from the chairman in the boardroom to the doorman on the boardwalk.

Quarterly 'decision-making' refresher sessions and strong internal and external mechanisms that not only protect whistle-blowers but reward them whenever they raise a question in relation to an issue that may jeopardise the best interests of the company.

Finally, swift action must be taken to remedy situations that are not in accordance with the best interests of the company. This requires solutions that take the company forward – every moment, every decision, every day – without fail – no excuses.

³⁶ Ibid.

³⁷ For more see Boddy CR, 'The dark side of management decisions: organisational psychopaths' (2006) Vol 44 No 10 *Management Decisions* 1461-1475. Also Pech RJ and Slade BW, 'Organisational sociopaths: rarely challenged, often promoted. Why?' (2007) 2 *Society and Business Review* 254-269.