THREE MODES OF CORPORATE GOVERNANCE: A CALL TO REFLECTION & EFFECTIVE ACTION- A NOTE

Gonzalo Jiménez-Seminario[1]

Abstract

The purpose of this note is to reflect on ways boards of directors can rejuvenate their work practices, particularly in dealing with decision-making in contexts of uncertainty, following the principles articulated by Knight (1921)[2]. This involves navigating circumstances beyond the ordinary course of business. This perspective is presented from a scholar-practitioner's viewpoint, grounded in the belief that there is nothing as practical as a good theory. The author discusses and examines various potential contributions to address such challenges, aiming to integrate them into a cohesive framework. Initially, the author reviews board design by Jay Lorsch and colleagues. Subsequently, best practices originally proposed by Chait, Ryan & Taylor (2005) in "Governance as Leadership"[3] are explored for their applicability to professionalizing the work of non-profit boards, with an examination of their potential extension to the corporate world. The author introduces personal contributions developed in the context of work with both family businesses and social organizations, incorporating an ethical perspective. The note concludes with the presentation of an integrative model outlining the reflexive role of the board. The proposal suggests that augmenting Lorsch, Chait, and colleagues' propositions with ethical and other governance frameworks from literature, enriched with practical insights derived from the author's praxis, could provide additional distinctions to enhance governance work. Throughout the note, the author reflects on practical experiences as both a board member and advisor to hundreds of boards over 30 years[4]. This scholarly wisdom is complemented by recent field research from the forthcoming book, "Corporate Governing in Latin America: The Importance of Scandals to Institute Change.[5]" The conclusion offers pragmatic suggestions to practitioners and thought-provoking ideas to scholars

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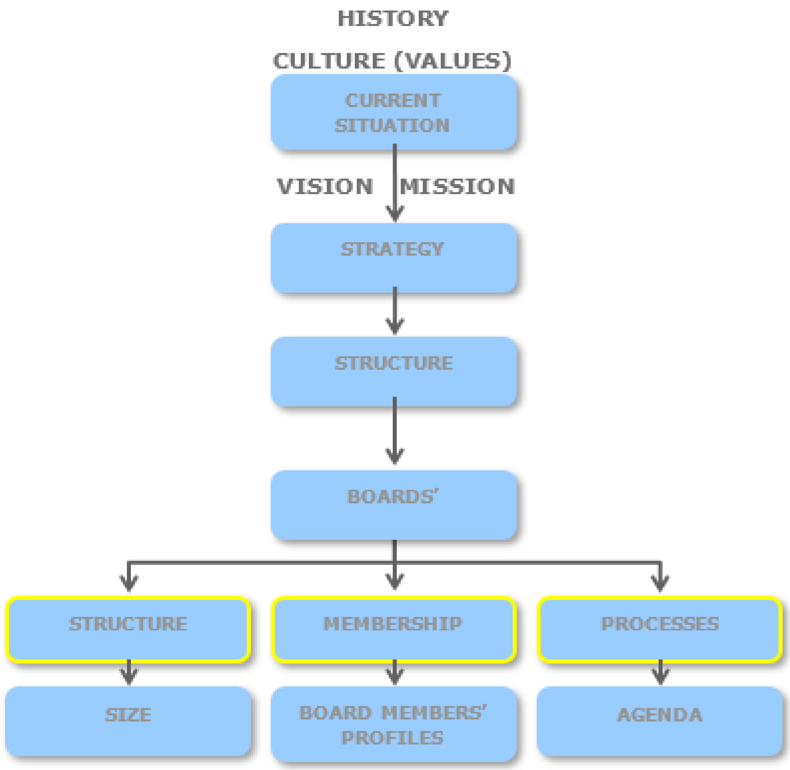
[1] Chairman and owner, Proteus Management and Governance, Chile

1. Introduction

In the capacity of a scholar-practitioner and as an integral part of the PROTEUS consulting team, there is a consistent effort to grapple with the challenge of enhancing the professionalization of corporate governance within diverse firms and institutions. The scope spans from large and medium-sized family-owned enterprises, family offices, to multi-business multinational family business groups. The clientele extends further to include cooperatives, mutual societies, trade associations, chambers of commerce, foundations, incubators, and a subset of start-ups embarking on the establishment of their inaugural boards. Predominantly Latin American, there is also representation from family groups in North America, Europe, the Middle East, and a growing presence from Asia, notably India and Japan.

The focus narrows to the most prevalent scenarios: family business groups strategically planning generational successions, whether from the first to the second or the second to the third generation (third to fourth in Europe and fourth and beyond in Asia). The customary initiation involves the identification of "designated equity successors," typically the children receiving an equal percentage of ownership regardless of their professional roles or gender. Subsequently, the engagement progresses to the formulation, through dialogue, discussion, and negotiation, of rules of engagement among family partners. This necessitates the transformation of their roles from mere brothers or cousins to co-owners, navigating a transformative rite of passage. This process often involves addressing past emotional liabilities, compensating for historical differences, or, at the very least, recognizing and accepting them. The pivotal point in a representative project lies in mapping out a roadmap to collaboratively construct a shared purpose, a common vision, and the fundamental organizational goals. Having navigated through these preliminary processes, the critical next step, transitioning into action, involves the establishment of an effective board of directors[6]. This encompasses the design of the board's structure, size, functions, composition, and processes, along with an initiation into familiarizing with sound governing practices.

The design model employed is adapted from the framework suggested by Harvard’s Jay Lorsch (refer to Figure 1), unfolding from an understanding of the owners' background, the company's situation, and its challenges. This sets the stage for designing the structure, composition, and contemplating the infusion of best practices into the emerging governance bodies.



Adapted from Lorsch, J., Colin, C. B., "Back to the Drawing Board". HBS Publishing Corporation. 2004. Pag. 9

In the remainder of this note, the focus shifts to the third pillar of Lorsch's model, specifically delving into best practices as it is deemed the core of governing in action. The examination begins with a sequential review of the valuable recommendations put forth by Chait and colleagues. This view is then enriched by incorporating insights from other academics in corporate governance, ethics, and the family business domains. These insights, often drawn from personal experiences inclusive of setbacks and successes, serve as illustrations and eventual counterfactuals. The discussion revolves around the "four usual suspects" of corporate governance performance, namely,

Role duality: Emphasizing the separation of chair and CEO functions to distinguish between managing and governing roles.

Independent directors: Advocating for the inclusion of non-executive board members to bring in external talent and expertise to complement existing capabilities.

Board Size: Discussing the appropriate size of the board, balancing the need for diverse voices and skills with the necessity for fair airtime for all participants.

Director Ownership: Recognizing director shareholdings, a natural occurrence in family groups but often unfeasible in social organizations.

While these factors are extensively discussed in literature, their impact on company performance appears inconclusive[7]. Nevertheless, the author expresses full support for the first two. Although managing partners often take leadership roles in family firms, a minimum board size of five (and exceptionally three) to a maximum of nine members is recommended. In family businesses, director shareholding is a constant, typically viewed as a forbidden fruit beyond the reach of external actors.

2. Best Practices

The frequently cited best practices include:

Strategic Agenda: Defining board priorities during a retreat and establishing an annual calendar for their timely accomplishment.

Role of the Chair: Organizing board work, engaging members, promoting open exchange of opinions, guiding the CEO, and fulfilling legal duties.

Establishment of Committees: Creating committees (auditing, financial, compensation, and governance) to focus on specific duties.

Executive Sessions: Holding sessions without the CEO to reflect on board dynamics, the company's future, and the CEO's performance.

Board Dashboard: Implementing a separate tool to monitor corporate strategy development and contributions of the board.

Board Evaluation: Utilizing external experts or self-reflective exercises to assess the quality of board work.

Board Diversity: Emphasizing the strategic value of diversity in terms of profession, gender, and background to avoid Groupthink syndrome[8].

These tools are recommended for adoption by any board, drawing from both academic and practitioner-oriented literature[9,10].

3. Board Leadership

Chait, Ryan, and Taylor (2005), following a thorough review of non-profit board governance, proposed the construct of Governance as Leadership. This framework, applicable to profit-oriented boards[11] based on personal experience, distinguishes Three Modes of Governance (refer to Figure 2), allowing boards to focus simultaneously on their roles as fiduciaries, strategists, and sense-makers.

Three Modes of Governance

	FIDUCIARY MODE	STRATEGIC MODE	GENERATIVE MODE
STYLE	HIERARCHICAL/ BUREAUCRATIC FRAME	ANALYTICAL/ VISIONARY	INTUITIVE/REFLECTIVE
PURPOSE	ACCOUNTABILITY/ GUARD	STRATEGIC DEVELOPMENT/ PERFORMANCE MONITORING	LEADERSHIP/ DISCERNMENT/MULTIPLE POINTS OF VIEW APPROACH
QUESTION	*WHAT IS THE PROBLEM?*	*WHAT IS THE PLAN?*	*WHAT IS THE QUESTION?*
PROBLEM	IDENTIFY	RESOLVE	CONCEPTUALIZE
DECISION	REASONABLE/ JUSTIFIABLE	STRATEGIC LOGIC	SENSE-MAKING
METRYCS	DATA, NUMBERS, FINANCE, REPORTS	KPIs, COMPETITIVE ANALYSIS	LEARNING, EXPERIENCE
CEO'S ROLE	HOLDS MOST LEADERSHIP RESPONSIBILITY	THE BOARD WORKS WITH STAFF TO ESTABLISH PRIORITIES	EXECUTOR
ORGANIZATION OF THE BOARD	ACCORDING TO ADMINISTRATIVE FUNCTIONS	STRATEGIC PRIORITIES, INVOLVED IN STRATEGY IMPLEMENTATION	VALUES-BASED DIRECTION

Adapted from Chait, R., Ryan, W. & Taylor, B. (2005) Governance as Leadership: Reframing the Work of Nonprofit Boards.

Figure 2

These three types are outlined as follows:

Fiduciary Type: Boards in this category play an oversight role for the organization, the business, and management. In family firms, as in any company, this role assures non-executive shareholders that the company is managed responsibly and soundly.

Strategic Type: Boards of this nature contribute to strategic thinking, monitoring performance to ensure the effectiveness and relevance of the organization in achieving its goals. While still in the process of adoption and improvement, family groups naturally orient toward results, which, can be leveraged and further cultivated in their problem-solving tasks.

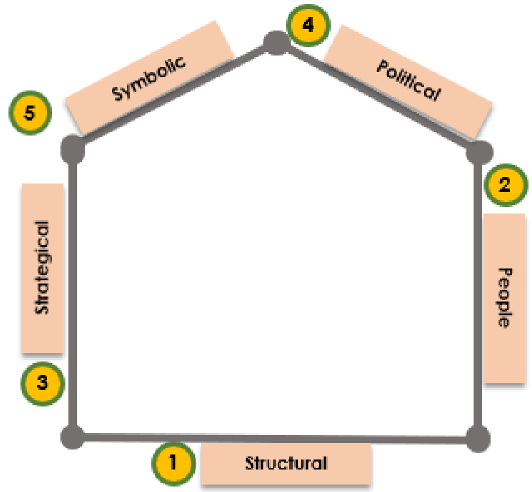
Generative Type: Boards of this type frame challenges, provide reflection and guidance, making sense of the organizational purpose. Generative thinking precedes strategic design and deployment, emphasizing that problem framing comes before problem solving. Therefore, the board is expected to enhance organizational cognition through the enrichment of adaptive practices[12]. In family firms, such discussions often occur in well-led family councils.

The fascinating aspect of these three modes is their simultaneous nature, all equally important and demanding a fully trained board to develop them. Cathy Trower, a doctoral student of Chait et al. (2013), has offered a practical guide for practitioners, recommended for those seeking a deeper understanding of their implementation.[13]. The challenge of training boards in family business groups and social organizations to fully adopt these practices is a continuous improvement process rather than a one-time, binary adoption. The crucial elements lie in having the right people, maintaining continuous self-challenge, and questioning the depth of generative work undertaken.

4. Frames to Practice Reflexive Governance

Despite the insightful contributions of Chait and colleagues and the practical advice of Trower, the generative mode remains somewhat obscure for practitioners. With the aim of clarification, we (with PROTEUS[14]) propose five specific frames to illuminate generative governance: structural, people, strategic, political, and symbolic perspectives (refer to Figure 3).

REFLEXIVE GOVERNANCE: 5 FRAMES TO PERCEIVE & GRASP ORGANIZATIONAL SITUATIONS



Source: PROTEUS Management, Governance & Effectuation (2020)

Collectively, these frames facilitate asking the right questions about corporate purpose, the rationale behind company actions, and envisioning new avenues for the future. Delving deeper into Reflexive Governance, the exploration continues with the five frames described in Figure 4.

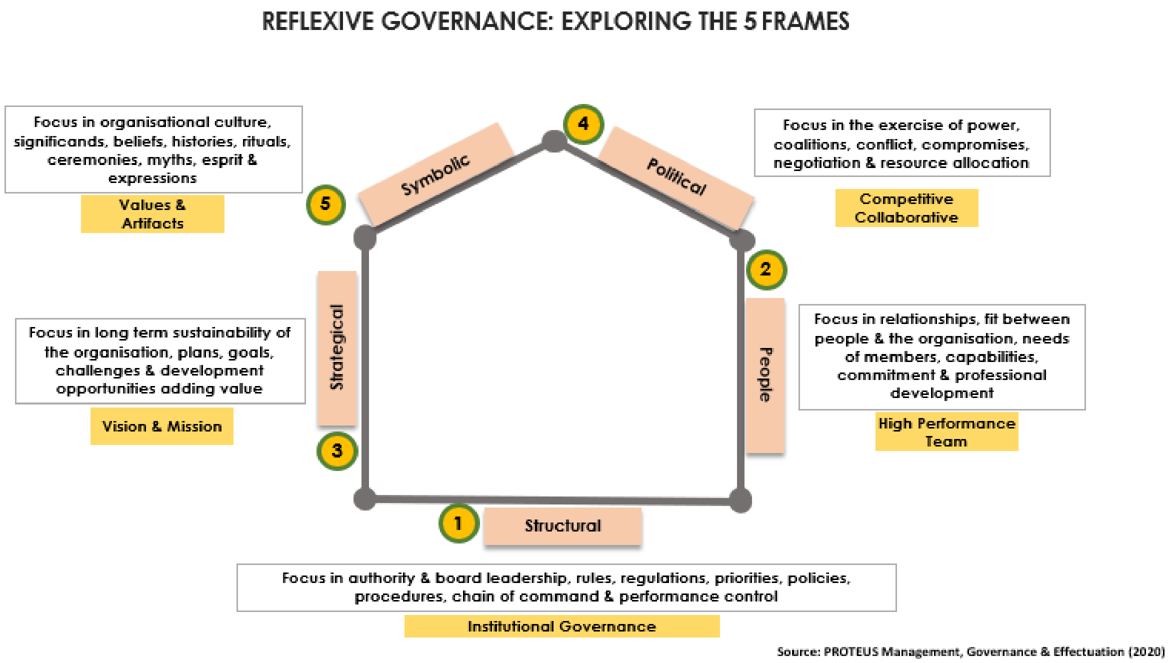
Structural Perspective: Initiating a generative viewpoint involves reviewing the organization's existing and missing governing bodies. This pragmatic stance helps assess what needs governance, by whom, under what charter, and the scope of activities. Focus extends to the authority and leadership of these organs, their rules and regulations, participation, information flow, and decision-making processes. This provides a fresh perspective on established priorities, policies, and procedures, informing critical thinking around structural designs and institutionalizing the governance function. Entrepreneurial family business groups often require structures matching the increasing complexity of their businesses and family connections, such as Family Council, Family Assembly, Owners' Board, Family office, Holding Company, Corporate Headquarters, among others[15].

People Perspective: Recognizing that boards are social bodies, attention is directed toward virtuous and vicious interpersonal relationships and intersubjective understandings. Questions revolve around the alignment between people and organizational purpose, members' needs, capabilities, commitment, and professional development challenges. Guarding against Groupthink, the focus is on fostering a high-performance team capable of self-coaching, committed to continual learning, and maintaining high standards. In family groups and closed-membership cliques, such as cooperatives, the quality of individuals, especially their shared values, is crucial. However, an insular approach can lead to isolation and disconnection from reality, emphasizing the importance of carefully selected external members challenging established paradigms.

Strategical Perspective: Acknowledging the primary task of any organization as survival[16], questions arise about the long-term sustainability of the organization. Contemplating provocative possibilities like organizational euthanasia, suicide, and execution opens discussions about plans, goals, challenges, and development opportunities[17]. Compliance with the imperative of adding value becomes crucial, and the option of ceasing to exist may be contemplated. In family firms and social organizations, this could involve the orderly dissolution of a partnership or its complete renewal.

Political Perspective: Embracing the idea that powerful individuals often act differently from what they should do, this perspective focuses on the exercise of power, types of coalitions, conflict management techniques, and the process of resource allocation. Machiavelli’s epoch (transition from Renaissance to Modern Era) is comparable in terms that an old system is cracking and the new one is not born yet[18]. In family firms, a similar perspective requires envisioning the reconfiguration of governance and managerial systems during generational changes, managing collaboration and competition among siblings and insiders and outsiders.

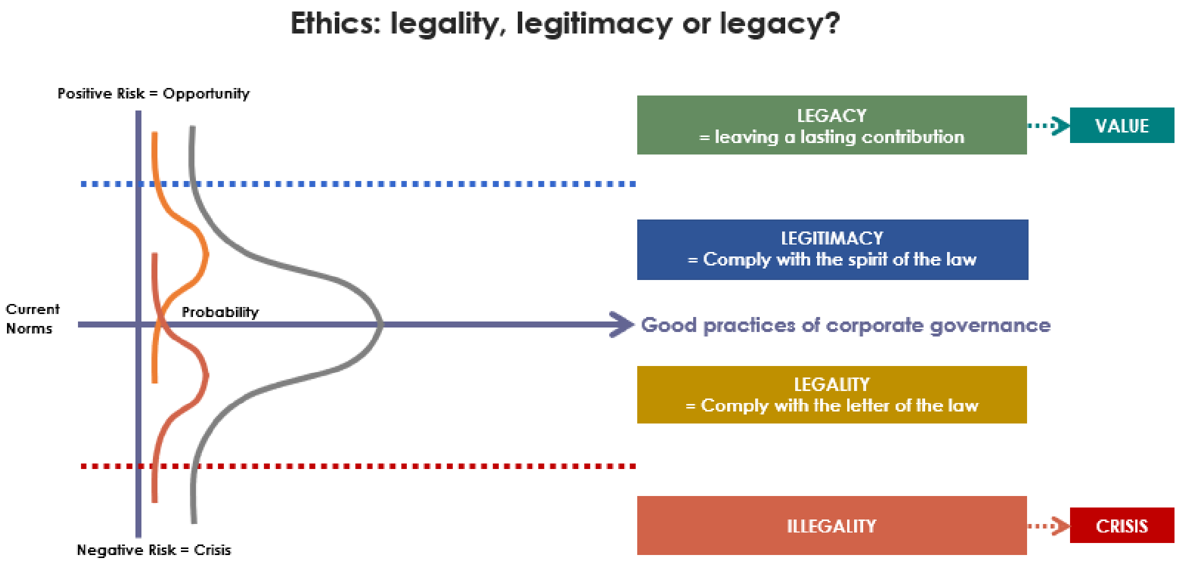
Symbolic Perspective: Acknowledging that individuals often conform to cultural rules and patterns, this perspective emphasizes the importance of organizational culture, symbols, beliefs, histories, rituals, ceremonies, myths, and expressions[19].From a generative governance perspective, this is not merely a laundry list but part of a consistent tree rooted in basic assumptions and values, flowing through espoused values to emerge as artifacts and behaviors [20]. Generative advisory work with a global family business group and a leading South American cooperative examined the coherence between public statements and visible artifacts and behaviors, reinforcing social capital, cultural fit, and a sense of belonging.



hese five frames are not exhaustive but should be viewed as a prompt to inspire and develop generative thinking at the board level.

5. From Illegality to Legacy

Paramount among family groups and social organizations is the question of ethics. The graduated scale of events between illegality and legacy comes in handy to reflect on the distribution of probabilities of events and behaviors[21]. He does so by introducing the proverbial Gauss bell moving from risk to opportunity. In Figure 5, a simplified adaptation is presented that has proved useful to reflect on current standards and engage board members to move up from mere compliance to leaving behind “beautiful footprints”. This is particularly relevant for transgenerational family groups keen on transferring their sense of purpose, historical commitments, and permanent values to the next generations, making them conscious of the old maxim: “to whom much is given, much is expected.”



Adapted from Verhezen, P. (2010). Giving voice in a culture of silence. From a culture of compliance to a culture of integrity. *Journal of Business Ethics*, *96*(2), 187-206.

Therefore, reflexivity is enhanced by maintaining an alert eye and an independent critical stance toward organizational conduct, not just its performance.

6. Conclusions

This note, therefore, serves as a call to arms for both scholars and practitioners to remain vigilant about the deeper board duties and the indispensable role of the board (and its chair) as the chief governance officer. It is subject to the main challenge of developing the corporate governance purpose and its underlying three duties, namely:

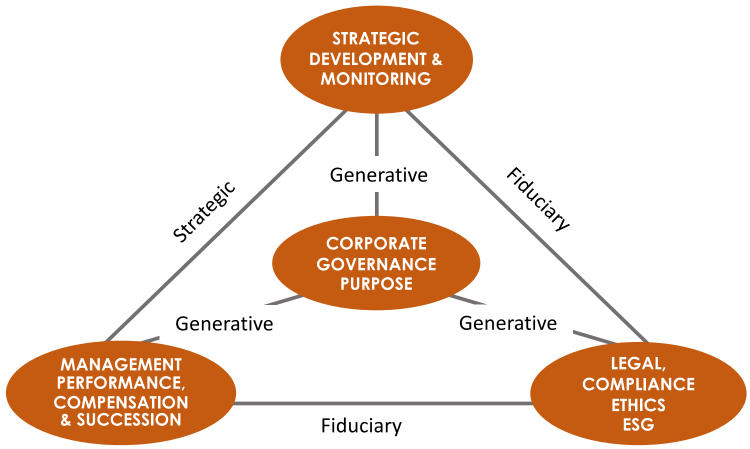
The strategic development of the organization;

The legal, compliance, ethics, and ESG requirements (or their replacements); and

The monitoring of management performance, the design of its compensation system, and its opportune succession.

Figure 6 illustrates the generative, fiduciary, and strategic connections between those four imperatives, which can further clarify the manner to fully integrate the three modes of governance.

Figure 6
BOARD ROLE : CHIEF GOVERNANCE OFFICER



Adapted from Carlock & Florent-Treacy (2006)
The HP-Compaq Merger: A Battle for the Heart and Soul of a Company
INSEAD Case, Reference no.306-234-1

Combined, the measures described in this article may contribute to changing the trajectory and promoting good corporate governance that can make contributions to society and protect the value of companies and the effectiveness of institutions.

In 1991, upon receiving the Sonning Prize, the former Czechoslovakian President Vaclav Havel delivered his famous "I Suspect Myself" speech. This suspicion of ourselves is the attitude that is especially needed in spaces of power such as corporate boards, but also among watchdogs, academics, and researchers. It is hoped that this may provide the right inspiration to all of them—practitioners, scholars, and regulators—to work in unison to co-create a better world.

References

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4 Although I speak in first person, much of what I have learnt derives from the conjoint work with my team of consultants at Proteus through 27 years of professional practice, whose contributions I gratefully acknowledge.

5 Callund, J., Jiménez-Seminario, G. & Pyper, N. (eds.) (2022, forthcoming). Corporate Governing in Latin America: The Importance of Scandals to Institute Change. Palgrave Macmillan (NY, USA)

6 Naturally, this might imply replacing, complementing, or succeeding an existing board or developing a full set of both holding and subsidiaries boards; establishing a Family Council; creating a Family Office, among others developmental activities.

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11 Chait et al., modestly assume that any profit-oriented board should naturally take a generative stance, which is not at all what I find in my professional practice, and when introduced to the generative mode, most of those boards struggle to make sense of their fundamental question.

12 Chait and colleagues quote as inspiration of this generative mode, Karl Weick’s sense-making; Donald Schon’s reflective practice; Henry Mintzberg’s emergent strategy; Ronald Heifetz’s adaptive leadership; Michael Polanyi’s personal knowledge; Lee Bolman and Terrence Deal’s framing organizations; and James March and Michael Cohen’s sensible foolishness. (p.83)

13 Trower op. Cit.

14 I gratefully acknowledge the contributions of my anthropologist colleague, Andrés Rivas, developing this framework.

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