Systems of Enterprise Governance and their Effects on the Economic Performance

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Abstract. *The systems presented by the world managerial theory and practice display the concern for finding solutions adapted to the permanent changes taking place in the external environment or inside the economic organizations. In the following, we will focus on the concept of enterprise governance, highlighting the ideas on which the functioning of this managerial system is based and its effects on organizational performance and on the stakeholders' satisfaction. The analysis of the more or less recent evolutions in various European countries, of the success and failures registered by now, allows us to draw out useful principles on which we could substantiate the managerial actions meant to sustain the immediate and future performance of the economic organizations.*

Key words: enterprise governance; economic performance; partnership approach; cognitive approach; organizational perenniality.

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1. The concept of enterprise governance and the context of its emergence

The emergence of the concept of *enterprise governance* is associated, first of all, with the shareholders' need to control the decisions adopted by the managers.

In this context, the choice of the governance forms and of the mechanisms used to regulate the managers' action aimed at a double objective:

a. providing the perenniality of the organization and,

b. maximizing its performance, according to the criteria defined by the shareholders.

a. This first objective shows that the concept of *enterprise governance* is not limited to taking into account the interests of the shareholders: the concern for the perenniality of the organization includes, even if it does not have the same intensity, the aspirations of other parties involved (stakeholders), first of all of the employees, but also of the banks, suppliers, clients or other institutions more or less connected to the enterprise activity. In other words, the concept of *enterprise governance* raises more fundamental questions: those regarding the efficiency, the value creation, the repartition of the richness created in a context in which the interests of the managers and of other involved parties are not necessarily convergent.

b. The concern for maximizing the enterprise performance regards the search for an optimal system of governance and for some tools able to regulate the actions of the managers according to the interests of the stakeholders and shareholders.

However, the problem regarding the control of the managerial decisions is not recent: it is associated with the separation between property and management and with the owners' awareness of the risk of spoliation represented by the absence of certain regulations that should empower the managers with the mission of optimizing the enterprise performances.

Nowadays, the problem of the managerial control and of the *enterprise governance* reached a new dimension and entered the heart of the debates regarding the managerial performance, for two main reasons:

- The increased role of the financial investors in the corporate development and,
- The managerial inefficient or fraudulent practices that marked the recent activity of more economic organizations.

In the following, we will discuss the two reasons:

▪ *The role of the financial dimension in the economic growth*

The end of the '90s was characterized by a wave of activities oriented towards external growth by means of mergers, absorptions, acquisitions, first of all in the field of information and communication technology, but also in more traditional activity fields.

Financial investors oriented their capital towards the western economies and brought about specific practices. This way it appeared and spread the model of *enterprise governance* that modifies the structure of power and imposes the request of transparency and rigor in the relationship between the managers and the shareholders.

In the centre of this model lays the imperative request for profitability and exigency towards the managerial performance, measured especially on the basis of several financial indicators (the action value, the added value). These aspects made the above model be called the "stock model of *enterprise governance*", with the financial investors being oriented mainly towards the action value.

▪ *The inefficient and/or fraudulent practices*

The existent governance system encountered strong turbulences caused by financial reasons, by the events of September 11th, 2001 and by the multiplication of the scandals that followed the discovery of the fraudulent accounting practices leading to the bankrupt of companies famous at that moment (ENRON – SUA, Parmalat – Italia). The shareholders began, more and more, to be afraid of:

- the risk of manipulation of financial information;
- the correctness of the financial analyses;
- the limits of the control operations and, naturally, the debate around the theme of *enterprise governance* was launched again.

The speculative deviations of the economic environment and the accounting maneuvers of many companies highlighted enough the risks of the enterprise *governance* oriented exclusively towards the financial objectives. Therefore, other aspects were also introduced in the model framework regarding the organization, especially those connected to the human resources and to the management of the environment.

2. The relationship between performance and enterprise governance

The theoretic framework treating the relationship between performance and *enterprise governance* reflects the concern (however old) for conceiving a system for regulating the managerial behavior in order to allow the maintenance, the defense or the strengthening of the shareholders' interests. An extensive agreement was made between those who considered the limitation of the managers' power useful and necessary, the restriction of their area of action and the control of their decisions. All these views can be grouped in two main theoretic orientations:

a. a theory that favors the stakeholders' point of view and that aims at impeding the managers to affect negatively the incomes of the capital owners.

The adepts of this point of view consider that:

- the shareholders are less informed, not having a direct access to management;
- most frequently, the contract binding the shareholders and the managers is incomplete (not all the situations likely to appear can be anticipated);
- there is a moral risk for the shareholders (the manager can take advantage of the asymmetry of information and of the incomplete character of the contract in order to optimize the utility to the prejudice of the shareholders' interests);
- it is necessary to conceive and to implement control systems that should monitor and control the managers' behavior;
- the efficiency of an enterprise is influenced by the disciplinary power imposed by its governance mechanisms, as they join the interests of the managers to those of the financial investors.
- among the mechanisms used to limit the decisional power of the managers we identify *internal solutions* (creating an active Council of Administration, a General Assembly of the Shareholders or using proper systems of remunerating the managers) or *external solutions* (using the labor market for managers, using the stock market, cooperating with the banks or with the financial analysts)

The analysis of all these mechanisms reveals the fact that the creation of the Council of Administration and the proper definition of its role, its structure and its power are essential, especially if we take into account the fact that this body applies systems of manager motivation in order to increase the performance.

The risk of getting fired can determine a manager to make himself/herself difficult to be replaced or to make sure that his elimination will make the shareholders pay an important cost. There are multiple situations when the manager chooses complex strategies for the company, strategies that only he/ she is able to apply or he/she makes decisions of investments, the efficiency of which depends on his/ her presence.

Taking into account all these aspects, the *enterprise governance* allows the shareholders to perform an exigent control and to make the managers search for ways of actions that are not likely to be sanctioned.

b. a theory less debatable that regards the relationship between the shareholders and the managers, that is based on the analysis of value creation and that takes into account the cognitive theories of the company

The main limit of the above mentioned theory is the fact that it takes into account exclusively the shareholders' point of view. Yet, obtaining a profit in a company involves several factors and, consequently, its repartition has to be fair in order to stimulate the efficiency. In this case, the system of *enterprise governance* (partnership governance) regards exactly such a repartition that can influence its long term existence. The main concern regards the optimization of "the value of the partnership" (not only the value of the shareholders status) and the setting up of functioning rules that could eliminate the potential conflicts.

According to this partnership view concerning the *enterprise governance,* there are various conflicts that can be avoided between:

- shareholders – managers (the shareholders bring the financial funds, the managers contribute with competence);
- employees – managers (the employees create value, the managers are interested in developing and valorizing the human factor);
- enterprise and various partners: clients, suppliers, banks or other organizations.

This extended theory interconnects the stakeholders and their satisfaction to the possibility that an enterprise survives on a long term.

3. Cognitive approaches regarding the enterprise governance

The traditional approaches are too normative and too static, so that the interest in the cognitive model regarding the *enterprise governance* is being justified. Unlike the former theories based on information, the cognitive model is based on "knowledge" (deriving from joining information and reasoning) and is interested in the process of adding value. Under these circumstances, the cognitive approaches focus on the competence and on the ability of the enterprise to innovate, to create investment opportunities and to modify the environment.

The need to harmonize the parties' interests is not so obvious anymore and the role of the manager is to anticipate and create new opportunities for his organization, to adapt permanently to the environment in order to provide a sustainable profitability. The systems of governance based on the cognitive model use the cognitive diversity, the debate, the organizational learning in the process of preparation and implementation of the proposed solutions in order to solve certain problems of mutual interest.

4. Mechanisms of regulation used in the enterprise governance

The models of *enterprise governance* use, in different contexts, specific mechanisms of regulation that correspond to the need of increasing the economic performance. These can enter two main categories:

- From the point of view of their affiliation to the enterprise, we can identify *internal mechanisms*, specific to the company (the Council of Administration), and *external mechanisms* (the labor market, the stock market, crediting bodies).
- From the point of view of their creation, we identify *deliberate mechanisms*, aimed at the control and limitation of the manager's autonomy area (disciplinary mechanisms), and *spontaneous mechanisms,* based exclusively on the "natural" game of market and institutions functioning.

If we intersect these two classifying criteria we get the table of possible mechanisms of *enterprise governance*:

Possible enterprise governance mechanisms

Table 1

	Mechanisms specific to the enterprise	Mechanisms non-specific to the enterprise
Deliberate mechanisms	Formal control systems Remuneration systems	The legal environment and its binding regulation
Spontaneous mechanisms	Informal surveillance mechanisms (implicit control systems already existent in the organization)	The managerial market, the financial market, the market of goods and services

Source: Depret et al., Gouvernement d'entreprise, De Bocck, Paris, 2005.

Among all the mechanisms presented above, the Council of Administration is obviously the key structure and the most analyzed structure *of enterprise governance*, taking into account the fact that it is the body that solves the potential conflicts between the managers and the shareholders. Firstly conceived as a body meant to control the managers (in the context in which the governance favors exclusively the point of view of the shareholders), the Council of Administration proved to be the guarantor of the interests of various stakeholders (the model of partnership governance mentioned above). In the cognitive model, the Council of Administration can become a "social network" helping the manager to accede to new resources, to privileged information, vital for drawing up the strategy.

The structure of the Council of Administration often reflects its role in the activity of the enterprise. We can thus see the place of the employees' representatives, of the financial bodies or of other important partners.

An interesting question regarding the structure of the Council of Administration is the following: is the presence of external independent administrators (they are not shareholders and often managers of other companies) in the Council of Administration of an enterprise justified?

The most common answer was positive: the existence in the Council of Administration of people coming from various geographical areas, bringing about information and experiences from various types of organizations, helps to avoid non-profitable strategies, to avoid taking unjustified risks, to diminish the tendency of managers' domination, guaranteeing thus the shareholders' interests.

Among the mechanisms non-specific to the enterprise, we retain the important role of various markets:

- First of all the financial markets, as they allow the quick checking of the possible inefficiency of the managers (reflected to a certain extent in the share price);
- Then, the labor market (here considered as the managers' market) also plays the role of regulator. Even if the replacement of a manager has a cost (research, recruitment, selection, training, remuneration…), the threat of going for an external manager can reduce the risk for the shareholders, except for the case when the current manager succeeded into "getting so strong roots" that can destabilize the enterprise.

5. The systems of governance of the European enterprise

According to their history and their culture, to their greater or smaller approach to the North-American economy, the European countries can display hybrid systems of governance that borrow various elements from the models already presented:

- the stock model, based on the financial markets;
- the partnership model, based on the interests of the parties involved;
- the network model, based on the interpersonal and social relationships between the various actors of the governance;
- the administrated model, based on the State intervention.

Probably it is not surprising the fact that we frequently meet the stock model in the Anglo-Saxon Europe (N-V), geographically closer to the American economy (especially in Great Britain and the Netherlands). In these countries, characterized by the presence of big multinationals, the financial and the managerial markets are the main mechanisms of enterprise governance.

Germany, which has economic characteristics closer by tradition to the partnership model, focuses on the important participation of the employees' representatives to the act of management and on maintaining old and strong cooperation, especially between the banks and the industry.

Many economic difficulties that Germany encountered in the last years made numerous analysts express their doubt regarding the viability of certain models of *enterprise governance* in which the Union plays an important role.

In Italy and Spain, a dominant model is difficult to identify because the differences of development from one region to another were (and still are) strong. However, despite the diversity, we could notice that, from various cultural reasons, the systems of *enterprise governance* are strongly influenced by the interpersonal relationships.

Conclusions

Discussing the theory and the practice in the field of the enterprise governance was aimed at highlighting an extremely important feature for the corporate management and for the economic performance.

On the basis of the observations registered by now, the fact that we will not be able to talk is obvious, at least not for a long time, about a *universal system* that could facilitate the good performance of the enterprise. As long as the capital moves to various geographic areas, the governance systems will adapt according to the local regulations and they will probably be less connected to the cultural factor. The whole formation process of the European Union is based on the intention of creating a unitary institutional framework, but it is far from favoring a European model of governance able to sustain the need of economic performance.

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