

## Corporate decision-making, corporate collapse and inefficiency.

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Companies are a nexus of decisions.<sup>1</sup> 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 (the same) in relation to its best interests.<sup>2</sup>

Corruption is 'something spoiled'.<sup>3</sup> 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 collapse begins with an ethical lapse in one decision – often followed by attempts to cover up the initial poor decision.<sup>4</sup> 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.<sup>5</sup> Because people are inherently flawed, corrupt decision-making is the norm not the exception.<sup>6</sup>

All decisions are confined to bounded rationality.<sup>7</sup> 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'.<sup>8</sup> 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.<sup>9</sup>

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<sup>1</sup>Chia R, 'Discourse Analysis as Organisational Analysis' *Organisation* 2000 Vol 7(3) 513-518.

<sup>2</sup>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).

<sup>3</sup>Caiden, G.E. 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' Paper presented to the *Australasian Political Studies Association Conference*, University of Adelaide 29 September – 1 October, 2004 at 11.

<sup>4</sup>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) at 75. See also, Jennings M, *The Seven Signs of Ethical Collapse* (New York, St Martin's Press, 2006).

<sup>5</sup>Id. See also Caiden note 3.

<sup>6</sup>Id.

<sup>7</sup>See Selten R, 'What is Bounded Rationality' SFB Discussion Paper B-454. A paper prepared for the Dahlem Conference May 1999.

<sup>8</sup>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, MA, Ballinger Publishing, 1981) at 50.

<sup>9</sup>'... no 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

Successful companies in the long term are those that make better decisions than their competitors.<sup>10</sup> No company is immune to corrupt decision-making.<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup>

Because optimal decision making is complex 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<sup>14</sup>, rigorous selection processes for hiring staff, zero tolerance for poor decision-making,<sup>15</sup> flat structures dominated by democratic processes<sup>16</sup> and real empowerment to challenge decision-making.<sup>17</sup>

In agency theory the agent's fiduciary duties are relied upon to mitigate against the propensity of the agent to engage in self-dealing.<sup>18</sup> In the corporate world fiduciary duties are enshrined in law and bolstered with additional provisions in an attempt to

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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) at 191.

<sup>10</sup>Collins states that being able to effectively adopt the 'Stockdale Paradox' will dramatically increase the odds of making a series of good decisions. See Collins J, *Good to Great* (Random House, 2001) at 87. 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 in this note at 86.

<sup>11</sup>'... corruption is contagious, and the more widespread it becomes, the more it infects and confuses those who want to do the right thing.' Brountas PP, *Boardroom Excellence* (San Francisco, Jossey-Bass, 2004) at 7. See also, Jennings Note 4.

<sup>12</sup>See KPMG 'The Future of Corporate Reporting: Towards a Common Vision' 2013.

<sup>13</sup>With reference to the HIH 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 HIH's corporate governance procedures would probably have measured up well, as a paper exercise, against most codes studied.' Maltas JD, 'The demise of HIH: What part did failed corporate governance policies play' Working Paper (No 05.02) Working Paper Series School of Business Law Curtin Business School Curtin University of Technology Perth WA at 72.

<sup>14</sup>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, D.C., and Longenecker, C.O., 'The Bathsheba Syndrome :The ethical failure of successful leaders' (1993) 12 *Journal of Business Ethics*, 265 – 273 at 267/8.

<sup>15</sup>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 are stated as such but on deeper searching this is not the case.)

<sup>16</sup>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.

<sup>17</sup>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.

<sup>18</sup>See Dal Pont GE, *The Law of Agency* (Butterworths, 2001) at 219.

ensure that directors in particular make decisions in the best interests of the company.<sup>19</sup> This is juxtaposed against the backdrop of maximising profits and returns for shareholders which is invariably interpreted within the context of the 'short-term'.<sup>20</sup>

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.<sup>21</sup>

This is also why reliance on reporting is not enough.<sup>22</sup> The advent of continuous disclosure and an increased emphasis on materiality go some way to creating a better environment for good decision-making.<sup>23</sup> These approaches make good business sense and companies ought to do 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.<sup>24</sup>

Trust is the ultimate currency of success in market driven economies and trust is enhanced by reliable information from noteworthy sources.<sup>25</sup> 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 costs companies time and money. This does not mean companies should not report only that reporting alone is not a substitute for good decision-making.<sup>26</sup>

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<sup>19</sup>See *The Corporations Act 2001* (Cth)

<sup>20</sup>'... the 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) at 5.

<sup>21</sup>'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, R.I., *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.' Note 8 at 3.

<sup>22</sup>See Note 13.

<sup>23</sup>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 'Integrated reporting: the influence of King III on social, ethical and environmental reporting' London 2012 at 51.

<sup>24</sup>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.

<sup>25</sup>See Andreoni J, 'Trust, Reciprocity and Contract Enforcement: Experiments on Satisfaction Guaranteed' University of Wisconsin unpublished paper 2005.

<sup>26</sup>One option might be to post all board minutes online for the decision-making processes to totally transparent. In this scenario a caveat would be created for specific confidential material that was deemed

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 HIH<sup>27</sup> without Ray Williams or Enron without Jeffrey Skilling or Kenneth Lay.<sup>28</sup> The 'elephant in the room' is most often that no one challenges the 'lion' and if someone does they are soon shown the door.<sup>29</sup> This phenomenon is not restricted to the boardroom. All companies suffer inefficiencies due to 'management politics' meaning that in many cases companies become de-facto fiefdoms and decisions revolve around information that strokes the egos and belief systems of management – further restricting bounded rationality.<sup>30</sup>

Employees work to earn a living to pay their mortgages 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 into '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) and 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.<sup>31</sup>

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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.

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

<sup>28</sup>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 Might Fall* (HarperCollins, 2009) at 8.

<sup>29</sup>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)

<sup>30</sup>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 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* at 2.

<sup>31</sup>'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, CT, Praeger, 2003) at 248.

Like the animal world, both the lion and the hyena are extremely 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.<sup>32</sup> 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 that 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.<sup>33</sup> Therefore mechanisms are required to identify and circumvent 'spin'.<sup>34</sup> Those making the best decisions possible have nothing to hide. Collins identified this in his conclusions about the senior executives that were able to make good companies great.<sup>35</sup>

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 require.<sup>36</sup> 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.<sup>37</sup>

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<sup>32</sup>Regulators are often the last to learn about the true nature of the business.

<sup>33</sup>'... good 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) at 235.

<sup>34</sup>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) at 66-67.

<sup>35</sup>See Note 10.

<sup>36</sup>Id.

<sup>37</sup>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) Vol 2 No 3 *Society and Business Review* 254-269.