IS COST CONTROL THE ULTIMATE MOTIVE BEHIND CORPORATE GOVERNANCE? – AN ANALYSIS OF THE UNDERLYING RELATIONSHIPS

ABM Abdullah
Md. Wahid Murad
University of South Australia, Australia
Md. Mahadi Hasan
Universiti Utara Malaysia, Malaysia

ABSTRACT

The key objective of this study is analyze the underlying relationships between cost control and corporate governance in an attempt to determine whether or not cost control is the ultimate motive behind corporate governance in an organizational context. It also analyses why it is important to uphold the shareholders' interests by a corporation and at the same time to minimize the costs that usually occur in that corporation. Our conceptual analysis supports the notion that corporate governance must help retain the best interests of all the internal and external stakeholders and safeguard organizational resources from misuse, abuse, or practice of self-interests of the managers. It also supports that since protecting an organization’s interest requires protecting the interests of all stakeholders, cost control by that organization should be well guided by the corporate governance principles in ways that provide strongest safeguard of interests of all those stakeholders. Thus, a sound corporate governance policy requires adopting the standards and mechanisms that would maximize stakeholders’ financial and non-financial interests and at the same time minimize the operational costs in an organizational environment. This study concludes that cost control and corporate governance must operate in pragmatic ways in order to improve efficiency and foster capabilities of the organization and to protect simultaneously the interests of all the stakeholders.

Keywords: Decision Dynamics; Cost Control, corporate governance, stakeholders’ interest

INTRODUCTION

In any corporations, operational cost appears to be an extremely important or a central element of business that tells what a business is all about. Operational cost of doing business probably would have been the most primeval economic psychology and realism of human civilizations, probably since the early era of ‘evolution of money’ that began to serve as the medium of exchange. Historically, businesses experienced with survival or failure, growth or recession, transition, development, prosperity, sustainable competence or economic disaster based on how they had driven costs in relation to revenue. Revenue itself is used to be highly influenced by the cost of doing business. Primarily, liquidity, profitability and solvency seem to be the key accounting elements that usually say aloud about the future economic status of a company and reach to the point of understanding as whether the business would meet the expectations of its owners or stockholders. The key element of stockholders’ expectations from corporations is to earn significant amount of profit or net income thereby increasing their wealth steadily in the longer run. Traditionally, most of the global business organizations worked upon this key issue to satisfy their owners and habitually set up the top priorities to please the owners by way of engaging their total efforts to cut costs and improve revenues. Paradoxically, cutting costs and improving revenues would not work in hundreds of circumstances and the business leaders who failed to achieve their profit goals may well have realized. A business organization works in a vast environment and the entire environment contains certain meaningful clusters, such as community, society, local area, domestic territory, regional locations or global boundary. A business must recognize and value all these clusters and their inhabitants who are potential stakeholders. Placing owners with absolute priorities seems to be a great oversight, because this psychology most likely plunges the management in many instances to take certain unrealistic actions that eventually destroy owners’ interests. Owners obviously should be placed as “top-priority stakeholders” who deserve to receive expected return on investment which does not necessarily mean to hurt the interests of other stakeholders. Hurting the interests of other stakeholders virtually undermine the status of the owners as unsatisfied stakeholders may begin disassociating with the firm in achieving its corporate goals resulting in the loss of sustainable competence. Brooks (2002) argued “It has become evident that a company cannot reach its full potential, and may even perish, if it loses the support of one of a select set of its stakeholders known as primary stakeholders”.

Keywords: Decision Dynamics; Cost Control, corporate governance, stakeholders’ interest
Many examples say that some companies aggressively took cost cutting measures by reducing employee welfare costs and internal supplies, constrained employees’ travel costs, entertainment costs or refreshment costs and slowed down the process of promotion in higher ranks. Results showed that the intrinsic objectives of such cost cutting measures became failed while the organizations faced lower employee productivity, poor morale and high rate of employee turnover costs. Some companies illegally and unethically inflated their corporate earnings in their corporate accounting statements and disclosures and provided restatements to please the investors or owners, such as, Enron. They finally lost the public image and their businesses had eventually been doomed to exist. Accounting rules enforceable in almost all countries stress the need for a company to disclose its financial information in conformity with the generally accepted accounting principles (GAAP) or conceptual procedures and the information must be based on a ‘true and fair view’. Placing owners or investors on top priority based on false or improper reporting in the accounting statements and corporate disclosures is, therefore, a financial and accounting crime.

In the wake of catastrophic news of financial scandals, investors’ confidence got terribly hurt around the globe, stakeholders suffered, and businesses came under fire. Think tanks, professionals and leaders began to readdress issues on how confidence-building measures could be developed to heal up the sufferings of the stakeholders and fortunately the issues of ‘corporate governance’ rouse to the vanguard in the global agenda. Most cited development has been the creation of Sarbanes Oxley Act enacted by the United States Congress. The Act, in one significant aspect, provides adequate provisions of how the directors of the board can be accountable to oversee management actions. An independent risk consulting firm, namely Protiviti conducted a survey on firms’ pursuance to the provisions of Sarbanes-Oxley Act in 2003 in the United States and reported that “…executives and directors also are taking actions that are resulting in major changes in corporate governance activities throughout their organizations….the Act and other regulatory developments are impacting everything from board composition to the roles of external and internal auditors” (Protiviti, 2003).

The purpose of this paper is not to enrich readers with how corporations install governance, rather it benchmarks a basic rule that firms’ decision-making process must be absolutely legal, ethical, and socially acceptable. This study draws multidisciplinary conjectures to reflect the sheer importance of “governance” –a symbolic “medicine” likely to control costs and substantially reduce risk factors. A “decision-dynamics model” has been presented (Figure 1) which can serve as a nerve center in the organizational decision-making process. Based on our analysis we have drawn some conclusions regarding certain traditional practices of firms that must be changed in new economic reality. Overall, we believe that leaders and managers would benefit from the discussions in terms of certain theoretical developments.

WHY CORPORATE GOVERNANCE?

In today’s world, corporate governance can be rated as a life-saving corporate medicine to cure all evil intentions of bad people or perpetrators by way of establishing a cohesive corporate culture where senses of law and ethics would logistically work without compromise and where there would be no rooms for truing a firm into a devil’s workshop. Jin (2003) states, “Agency Theory and Asymmetric Information Theory underpin the inherent costs involved in a capitalistic environment where investors provide the money, management controls its usage, and regulators keep watch over this relationship”. A firm can face devastating cost consequences from several major reasons that may lead to a dangerous threat placing the firm in utterly completed position to survive. For example: leadership failure or violation of corporate norms and practices. “If a firm violates the norm or fairness, stakeholders may attempt to interfere with the company’s activities, sometimes by providing unflattering information about the company to other stakeholders, which ultimately raises the cost of doing business” (Schuler & Cording, 2006). Corporations must be expected to have excellent leaderships, social norms and practices, everlasting “greater good” orientation for greater community and society. Also, corporations must solicit the fact that “to be ethical and legal” is supposed to be the only way; firms should behave in its corporate attitude in ensuring trust and confidence of the stakeholders and the public at large (Raquib, 2003). Failure to do so or failure in leaderships or unexpected unethical steps may potentially ruin the faiths of stakeholders. However, history shows these happenings were apparent in the past. To prevent or protect a firm and its innocent stakeholders, logic says there is no alternative to sound corporate governance. When a firm designs its socially acceptable corporate behavior, we know it as “corporate governance”. Again, it seems like a community medicine (vaccine) to prevent firms from incurable commercial diseases.
CONCEPTUAL RELATIONSHIPS BETWEEN COST CONTROL AND CORPORATE GOVERNANCE

In Figure 1, a ‘Good and Bad’ decision-dynamics model can effectively run a corporation’s long term operation that could build a sustainable public confidence and resultant market competence. To run this decision-dynamics model, a good corporate governance framework is necessary. Underlying assumptions of this model are:

1. The model serves as value-provider to every stakeholder;
2. The model is perceived to be uniquely acceptable by any professional or the organizational leader;
3. The model cannot be usable in a corporate culture without a good governance framework and practices of such a framework;
4. Organizational accountability, integrity, independence, professional due care, reliability and transparency are needed to effectively operate the model; and
5. The use of the model can backfire by unethical leadership, erroneous values, vision and incompatible business strategies.

Figure 1. Conceptual Relationships between Cost Control and Corporate Governance.
Analysis of the Relationships

The model depicted here is of crucial importance in new commercial, legal, economic, social and political realities. It serves as a multi-disciplinary model. Following are the perceived descriptions of the elements of this model which is expected to serve as a dynamic, realistic, socially enriching, value enhancing and sustainable theory of modern decision making process:

Qualitative Decision

To be a qualitative decision, leaders and managers examine that the decision is based on total quality management (TQM) and it should be widely perceived that the decision will add value to its value chain thereby increasing stakeholders’ satisfaction. Since its name suggests “total quality”, we believe that other strategic management initiatives and options which came either before or after the invention of TQM should also be included in the definition of total quality management (TQM). Some of the strategic management initiatives are: Business Process Reengineering (BPR), the Balanced Scorecard (BSC), Enterprise Resource Planning (ERP), Computer-Assisted Manufacturing (CAM), Agile and Responsive Manufacturing, Customer Relationships Management (CRM), Activity-Based Management (ABM), Activity-Based Costing (ABC), Just-in-Time (JIT), Theory of Constraints (TOC), High-Performance Culture (HPC), Empowerment and Decentralization etc. We believe that through cross examination of these strategies, managers could exploit and create decision options to select the best one to ensure total quality that would eventually contribute to the value chain of their businesses. These strategic tools can be efficiently and effectively examined with the right definitions and exposures of resources, skills, training, transparency and accountability, organization’s mission, visions, objectives and goals. Unique leaderships, strong governance, empowerment and teamwork through participative management would build a dynamic corporate culture that could be devoted to cater to the needs of the corporations in this agile and competitive business environment. Perceivable quality decisions based on above strategic management options must be legal, ethical in all perspectives, equitable, and fair for the firm’s stakeholders.

Stakeholders-Friendly Decisions

Organizational decisions must be stakeholders-friendly which means to maximally satisfy all stakeholders of the business. Although it may be virtually difficult or impossible to satisfy all stakeholders to the extent of their expectations, managers must trade off their choices so that potential disappointments on the part of any stakeholder would not arise or at least each stakeholder may be convinced on the choices of managers’ decisions by understanding managers’ realistic inability to satisfy their hundred percent expectations. Stakeholder-friendly decisions may appear to penetrate the investors’ confidence as the mounting social image of the firm could potentially create public acceptance. No one should disagree that from the legal and ethical points of view, working for public interests is the only choice or key in the decision making process no matter how and why a firm concentrates on its liquidity, profitability, solvency or wealth creation process. When a firm sets its absolute mission to achieve its profitability for its owners, it sounds like a self-inflicting process of hunting its long-run business sustainability. Instead, the mission should draw ample areas on public interests and that may work like a tonic for ground breaking performance, provided the firm by its “words of mouth” and “acts of actions” reflect consensus and consistency. If there is any gap between the ‘words of mouth’ and ‘acts of actions’ there might be damage to the firm in earning public trust and confidence. As a result, there would be likely possibility that the investors would suffer from hatred frustration and disappointment. To earn public supports, a firm must act in the best interest of the public and therefore they need to employ professional attitude toward decision-making process which must satisfy some ubiquitously important qualities such as, integrity, accountability, objectivity, due diligence and care, reliability, consistency and transparency. Above all, every living system within and outside the organization must be given appropriate value. These are the acceptable processes in nurturing a sound corporate culture. Hence, Wing (1997) writes: “Culture, markets as systems, modes of planning, thinking, inclusion and participation can each aid the organization as it lives its life as a living system”.

Cost-Effective Decision

This may be the most ancient theory of the organization decision making as, in terms of history; the organizations always looked through profitability, solvency and wealth-maximizing efforts by using cost-benefit analysis. We still support this concept, but not on wrongly perceived ideology that cost reductions will necessarily increase perceived
revenues or serve as important tool for cost control. Cost computations should be based on activity-based costing (ABC) as this would enable the managers to have better abilities on cost control by changing, remodeling or altering activities, sub-activities; providing better methods, processes; adopting new technologies or changing skills of the workforce. By measuring and analyzing variance from period to period, managers can be able to improve systems and processes. Cost control is essential ingredient to make cost-effective decisions. Traditionally, the thinking had been centered on reducing the cost in any way possible. However, we reiterate here that reducing the cost would not always work as a strategy of cost control. Many activities need increasing the costs for better function of cost control strategies or additional costs may be needed to build assets which would eventually increase revenues. Examples: (1) Additional costs after a sophisticated pay system or incentive plan may generate accelerated motivation among the employees to raise productivity and performance that lead to earn greater revenues; (2) additional training costs would enhance employee skills and capabilities that can lead to better performance which could enhance revenues. (3) additional costs needed to renovate a plant facility may create better asset, production possibilities and environment for accelerating performance which would increase revenues (4) Operating income can be improved not only by increasing sales (revenues) but also by improving maintenance. Improved maintenance would reduce cost by decreasing the likelihood of machine malfunctioning and undue work stoppages. “Prevention is better than cure” and the managers can save substantial costs by ensuring machine and process maintenance. According to Todaro & Smith (2003), cost-benefit analysis can be defined as “a basic tool of economic analysis in which the actual and potential private and social costs of various economic decisions are weighed against actual and potential private and social benefits. Decisions or projects that yield the highest ratio of benefit to cost are usually thought to be most desirable”.

Legal and Ethical Decision

Decision must be legal and ethical in all perspectives. Multinational firms must have to undergo thorough cross examinations of distinct cultures, legal formalities, and ethical practices, social, political and religious values in different parts of the world to make sure that their global decisions are legal and ethical in all perspectives. Good corporate governance may serve as cornerstone of the firm’s legal and ethical standing. Culture should be cultivated in a way that could support the environment to protect and prevent the organization from corporate lapses. To uphold the motivation of legal compliance and ethical practices, organization should create an awareness program in which employees learn legal matters and ways to maintain ethics. Besides maintaining legal division or unit an ethics division or unit can be maintained which will look into ethical perspectives on sensitive issues and investigate ethical lapses or complaints. In this way a firm can prevent any unusual legal battle that may cause to pay significant amount of court fees, attorney costs and penalties or can avoid any significant ethical lapse that may constitute an intimidating circumstance. Sound corporate governance supporting legal and ethical issues in the decision process may serve as risk management tool to nurture charismatic corporate culture that may lead to excellent cost control and prudent organizational management. Wing (1997) states: “Not only our basic philosophies about unlimited growth, but the basic ethical decisions about consumption, waste, recycling, worldwide energy consumption, human population levels, etc. need to be factored in to the basic decision processes for sustainable organizational management”.

Equal, fair and Justified Decision

Decisions must be fair and justified and be based on doctrines of equality, accountability and responsibility. Organizations should be careful in making comments on social, political or religious issues as these are too sensitive to radically identify the reactions of the public or the governments. Public sensitivity may either improve or tarnish a company’s sustainable market competence and therefore, decisions relating to publicly sensitive issues must be scrutinized first before divulgence to the public. A macro issue is important here that we are the same humans on this living planet – and racial, religious, geographical or political diversity should not distract each other from the concept of “global citizens”. Organizations must have to cultivate and nurture the concept of “global citizens” and their decisions must not ignite public sentiments as sensitivities could likely destroy their business mission, corporate goals or objectives. In short, their words of mouth and acts of actions must be devoted to the concept of common welfare of the global citizens.

The essence of corporate governance is to tell all concerned that it does not only have roles to direct or monitor operations of the company, but also build a solid awareness that everyone must be respectful to each other’s individual and collective rights and interests. Owners usually have the supreme expectations to get accelerated profits or wealth mostly driven by short-term performance. However, they should alter their position into a
democratic and conceivable formula that the firm must be sensitive enough to all stakeholders in terms of principles of justice, quality, fairness and priorities. Sound practices, good priorities, acceptable decisions by the leaders and managers may build long-term business confidence, competent business sustainability, and unbreakable reputation. Hurdles, impediments or challenges may be treated as opportunities, not the threats as charismatic leadership, strategic options, knowledge exercise, uses of the experts and indissoluble vision may build and sustain the company leadership in the marketplace. These are all good or supreme qualities that the leaders should nurture and once leaders show these qualities, we could term it as “proactive leadership”. Leaders and managers should be strict with organizational prosperity over their self-interests at all times as the organizational prosperity will definitely award them with higher wages in the long run when complete sustainability is achieved. Complete sustainability can be defined as occupying major shares in the marketplace while rivals cannot destroy company capabilities in easiest or endurable ways. Nevertheless, an organization needs to develop a solid HR plan for logical, rational and consistent progressions of career, executive compensation plan, employee salary enhancements and improvement of benefit packages in order to keep the motivation and morale of the executives and employees high at all times.

Financial Efficiency and Profit should not be considered over corporate and social justice. Corporations must weigh heavily on social justice and this motivation might enable corporations to track all the evil things to avoid, protect and prevent from occurrence and recurrence. Once occurred and revealed, the corporate cost might destroy the company in part or the corporation’s life could be seized to exist, stakeholder suffered and the community harmed to a large extent. In this scenario the social cost cannot be recovered as well. The modern transformations of civilizations over the hundreds of years have been possible for four dynamic forces: (1) Educational Leadership; (2) Political leadership; (3) Corporations and (4) Scientific innovations of technology. Without the dynamic roles of the corporations, scientists, educational and political leaders would not ever have seen such a progressive and modern society in a new economic reality. While corporate cost of scandals killed some corporations, paralyzed the investors’ confidence, disappointed thousands of stakeholders, smashed the earnings of millions of breadwinners, and destroyed the dreams of scores of families, equal, fair, responsible and justifiable decision making platform is the only key to get rid out of potential corporate catastrophes.

CONCLUSIONS

Good corporate governance underpins market confidence, integrity and efficiency, and hence promotes economic growth and financial stability (Kirkpatrick, 2004). In today’s world, corporate governance stands as a robust management philosophy, which intends to provide admirable intellectual ascendancy of doing business. The intrinsic objective is to ensure that all future actions of an organization and its people will be based on principles of equity, fairness, justice, transparency, ubiquitous accountability, integrity and objectivity in order to satisfy its stakeholders. Interminable responsiveness to stakeholders’ individual and collective interests being in line with the adherence to strict ethical and legal principles and corporate core values is the essence of corporate governance. A business must move in the right directions with a solid corporate philosophy that everything it needs to accomplish be based on welfare objectives. To achieve a status of mass public acceptance and to draw significant public image in order to create a rapport building exercise leading to establishing a far-cited endeavor is a strategic goal of corporate governance concept. Its features are well nurtured, purposefully designed to turn a business into ongoing success and performance resulting in creating indissoluble corporate capabilities. Certain special aspects and natures of cost behavior that demands both increase and decrease of costs in order to enhance business value and as a result it seems possible to satisfy all the stakeholders provided corporate governance principle work in all situations. Cost control and corporate governance must operate in intellectual ways to improve efficiencies and foster organizational capabilities.

ENDNOTES

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