Paper no.3

Towards “integrated governance”

Value based management approach

Abstract
Corporate governance has recently received much attention due to the recent failure of the large corporations such as: Enron in the U.S.A. While several codes have been established to protect the shareholders’ rights, it has been proved that focusing on the accountability only is not enough because it doesn’t guarantee the corporate success. So, it has been suggested to consider the performance side focusing on the value creation to have more integrated governance. On this research, it is suggested to use the value based management (VBM) approach to integrate governance focusing on the strategic role of management accounting.

1-Introduction
Corporate governance is considered one of the most controversial issues on both of the academic works and Practice. While the corporate governance codes and regulations were necessary to protect the shareholders’ Rights, it has been proved that focusing on the accountability is not enough. Performance also should be considered. While the importance of integrating governance, there are very few studies (e.g. CIMA Strategic scorecard, 2004) that have tried to operationalize this integration in terms of best practices and techniques. so, the motivation of this study is to operationalizing the concept of integrated governance using the VBM approach, testing to what extent the VBM can contribute to a great value for shareholders and protecting their rights and examining how can the management accounting practices support implementing VBM, hence creating the shareholders value.
By achieving these objectives, this research may contribute to the literature by introducing a pragmatic approach to translate the construct of integrated governance into practices and providing a framework for how can management accounting contributes to shareholders value creation. In spite of the importance of such issue, to our knowledge, there are very few studies that have addressed this issue, the matter which motivates us to conduct this study.

On this part we give a brief explanation for the scope of this study.

1-1 integrated governance

There has been considerable discussion in the academia literature for managerial agency problems that arise from the separation of ownership and control. A number of corporate governance mechanisms has been proposed to ameliorate the principal-agent problem. These proposed governance mechanisms proposed in prior literature include a smaller board size, more outsiders on the board, more board meetings, a high CEO pay-performance sensitivity, higher managerial ownership, higher institutional ownership, a stronger shareholder and effective audit committee (Chidambaram et al., 2007)

However, the proposed corporate governance mechanisms are focusing on the accountability or the conformance side paying less attention to the performance side. Recently, CIMA and IFAC have developed a governance framework integrating the conformance and the performance together in one framework “enterprise governance”. The basic notion of this framework is that at the heart of enterprise governance is the argument that good corporate governance on its own cannot make a company successful and there is another important dimension for the enterprise governance should be taken into consideration which is the business governance
“performance”. This dimension (performance) focuses on strategy and value creation and helps the board to make strategic decisions. Companies also must balance conformance with performance.

In more recent work, Busco et al. (2005) have gone further and argued for an integrated governance framework which combines conformance, performance and knowledge management. Using case studies of global organisations, this project studied the role of performance measurement systems and in particular the way in which financial and non-financial information are integrated in a common global measurement language.

Furthermore, Fahi et al. (2005) have argued that we have to go beyond the governance suggesting a new framework to the enterprise governance including three main dimensions: Conformance, performance and corporate responsibility. According to this framework the relationship between the two main dimensions (conformance and performance) is interchangeable as the conformance can lead to creating value and the performance can lead to the assurance.

By exploring the very few studies which has dealt with the tension between conformance and performance we can conclude that, there is no complete agreement about the dimensions which can shape this integration. In addition, the concept of integrated governance needs to be operationalized in terms of the best techniques and practices.
1-2 value based management

An increasing attention has been given to the concept of value creation on the last period, for example The Financial Times report this fact on 14th of July, 1998 saying that during 1990s, the prioritizing of Shareholder value creation was increasingly identified as corporations’ *raison d’être* (Ezzamel et al., 2008).

According to CIMA, (2004a), “the VBM approach became popular in the mid-1980 when Rappaport published his seminal text, creating shareholder value: the new strand for business performance in 1986. “ Fahí et al., 2005 indicates that, the concept of managing for value has become on the forefront of many of the recent literature in strategic management.

Furthermore, Ittner and Larcker (2001) have proposed a VBM framework for managing and measuring businesses with the explicit objective of creating superior long-term value for shareholders including six steps which are the most common in practices as follow:

1. Choosing specific internal objectives that lead to shareholder value enhancement.

2. Selecting strategies and organizational designs consistent with the achievement of the chosen objectives.

3. Identifying the specific performance variables, or ‘value drivers’, that actually create value in the business given the organization’s strategies and organizational design.

4. Developing action plans, selecting performance measures, and setting targets based on the priorities identified in the value driver analysis.
5. Evaluating the success of action plans and conducting organizational and managerial performance evaluations.

6. Assessing the ongoing validity of the organization’s internal objectives, strategies, plans, and control systems in light of current results, and modifying them as required.

After critically reviewing the empirical research in managerial accounting on VBM Ittner & Larcker observed that researches are needed to determine whether all six steps in VBM process are needed to achieve superior performance. They also noted that studies to date have examined only one or few of the links in the process, and provide no evidence on whether the broad set of VBM practices adds greater value jointly than individually. The matter which needs future researches to address.

Some studies concluded that companies that have adopted the VBM programmes have been credited with delivering exceptional value for shareholders. For example, Lloyds TSB doubled its shareholder value every three years after implementing VBM programme (CIMA, 2004a).

The empirical studies also have tested how the use of residual income based measures such as EVA can ensure goal congruence between the principal and agent and examined the explanatory power of economic measures compared with the accounting measures for the stock returns but the results are mixed (Ittner & Larcker, 2001)
Finally, the CIMA technical report about maximizing shareholders value (2004a) has concluded that:

“Value-based management thus places the interests of owners of companies back in the centre of decision-making. This in turn means those investors can rely on more than just the instruments of corporate governance to protect them from the possible conflicts of interest arising from the split between ownership and management. In this way, managing for value has the potential to bring the two sides of the enterprise governance framework closer and join them in a more comprehensive approach to management.” (CIMA, 2004a).

1-3 management accounting practices

the value based management can be considered the fourth evolution stage in management accounting practices according to The International Federation Of Accountants (IFAC, 1998) where the attention of management accounting practices has been shifted by 1995 to the creation of value through the effective use of resources and using the techniques which examine the drivers of customer value, shareholder value and organizational innovation. The evolution of management accounting imply using a set of techniques and practices that are externally oriented and out-ward looking such as strategic management accounting techniques which help to determine the competitive advantage of a business, using strategic performance management systems such as: Balanced scorecard to translate the strategy into a set of performance measures to align the management practices and the decision making with the strategic objectives. Thus, may contribute to implementing the VBM approach successfully.
2-Research problem (Question)

Studying the reasons behind the failure of the large corporations such as: Enron revealed that the poor corporate governance is not the only factor that has led to such failure, there are some evidences that the poor strategies, ineffective risk management, weak strategy execution and inability to respond to fast-changing market conditions are of equal, if not greater importance (Fahi, et al., 2005).

This important conclusion leads us to try to answer the following question “How the corporation adhere to conformance and to have a superior performance at the same time to achieve sustainability?”

On this study we suggest to use the VBM framework to address this problem by focusing on the role of management accounting in integrating governance, which agrees with the new evolutionary strategic role of management accounting.

So the main research problem is whether the VBM approach is capable to integrate governance achieving the balance between conformance and performance through creating the shareholders value? And whether the management accounting practices can contribute to the shareholders value creation through the successful implementation of VBM approach?
3- Research method

To answer the research question, this study is planned to apply a case study approach on two sub-samples of the Egyptian manufacturing corporations. Three corporations that have adopted the VBM approach and three other corporations from the same industry, have relatively the same size but don’t adopt the VBM approach.

To determine which companies could be included in our sample we can use the published public data, surveys of the consulting groups and the pilot work by visiting those corporations. The research data is to be collected through in-depth semi-structured interviews, complemented by elements of observation, collecting documents and analysis of published public information in order to ensure some element of “triangulation”.

The interview schedule includes CFO, CEO, management accountants or controllers, managers from different departments. All the interviews are planned to be tape-recorded and transcribed, written documents to include annual reports, mission statements ………etc. The data analysis and coding is planned to be done using the Nvivo software to analyze the qualitative data in order to compare the results and to reach the conclusion.

The comparison between the two sub-samples will include comparing the performance results using financial measures (such as: ROI, EPS, margin on sales) and non-financial measures (such as: capacity utilization, market share). In additional
to, comparing the corporate governance practices in terms of to what extent the corporations comply to the principles of the Egyptian code of corporate governance.

From our point of view, the case study approach is more relevant to this study because it can help to get a close understanding for the way that the corporations formulate and develop their strategies in order to create the shareholders value, how they relate those strategies to the performance management system, how they determine and manage the value driver….so on, the matter which is difficult to be recognized without direct contact.
References:


