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“Social Blowback": The Achilles’ heel of Modern Corporate Governance

- What if it were true that the current single-minded emphasis on designing corporate governance systems to improve the lot of shareowners, and its corollary, i.e., the systematic omission of other stakeholders, i.e., employees, customers, competitors, actually harmed shareowners?

“Political Blowback”

- “When the United States sent guns and money to the Afghan mujahideen in the 1980s, it aimed to enhance US security by working to expel the Soviet army from Afghanistan. But a decade later this same mujahideen became the spearhead of Islamist terrorism. The seriousness of the blowback became clear to the United States with the 1993 bombing of the World Trade Center: "all of the attack's participants either had served in Afghanistan or were linked to a Brooklyn-based fund-raising organ for the Afghan jihad that was later revealed to be al Qaeda's de facto U.S. headquarters." (Bergen and Reynolds).

Examples of corporate “Social Blowback”

- Strikes.
- Boycotts.
- Class-action lawsuits.
- Anti-company blogs.
- Controversial documentaries and exposés.
- Parodies.
- Computer viruses.
- Targeted legislation.
- Customer anger, mistrust and defection.

Two theses:

- 1. Two important contemporary governance institutions, namely, a. the organizational structures of upper management and boards of directors, and b. internal corporate compliance and ethics programs, are poorly designed to confront stakeholder issues and often encourage the possibility of "social blowback."

- Two exogenous forces that now influencing these governance institutions, namely, a. Sarbanes-Oxley style regulatory initiatives; and b. the dominant theories of competitive advantage taught to modern managers, (the Resource Based View and Michael Porter's Industry Structure view) are also poorly conceived to avoid social blowback.

1. Endogenous: The organizational structures of upper management and boards of directors

- Broader nominating opportunities for board members, more independent directors, more independent directors on audit committees, new compensation limits on stock options, limiting the use of "pro forma" accounting methods, rotating audit partners – all of these measures are worthy adjustments on behalf of shareowners. But they leave untouched critical blind spots in corporate decision making, indeed, blind spots that can and have demolished the financial fortunes of great companies.

1. Endogenous: The organizational structures of upper management and boards of directors

- Boards of directors currently lack good information conduits for stakeholder issues and attitudes. Few if any reforms touch this issue.
  - The issue of splitting the Chairman and CEO is relevant to this issue.
  - Independent sources of information about stakeholders is relevant to this issue.

2. Endogenous: Corporate “compliance” and ethics programs:
-A false sense of security harming shareholders

- Especially popular in the United States since the US Sentencing Commission in the early 1990s specified that companies can decrease financial liability for corporate crime if they have a “bona fide” ethics and compliance program, these initiatives create “ethics officers,” hot lines, open-door policies, codes of ethics, and ethics training programs.

2. Endogenous: Corporate "compliance" and ethics programs:
-A false sense of security harming shareholders

- Enron, WorldCom, Tyco and the other Enron-era scandal companies had elaborate compliance and ethics programs. So too did the companies involved in the investment banking scandals, the mutual fund scandals, and the insurance industry scandals (e.g., AIG). Indeed, a recent study indicated that pressure on executives to compromise ethics actually increases in the presence of corporate codes of ethics and ethics training programs The (ERC 2000 National Business Ethics Survey.)

3. Exogenous: Regulatory reform, especially SOX-style initiatives.

- By SOX-style initiatives I refer to the collection of US and international corporate governance initiatives such as Sarbanes Oxley, the IFRS 2 ("International Financial Reporting Standards 2) reforms, and the rules and policies that continue to emerge from semi-legislative bodies such as the New York Stock Exchange.

3. Exogenous: Regulatory reform, especially SOX-style initiatives.

- SOX-style initiatives adopt an "instrumental" view of the function of the corporation whereas the microsocial contracts among economic participants generally reject such a view (Donaldson and Dunfee, 1999).

3. Exogenous: Regulatory reform, especially SOX-style initiatives.

- As these spheres of values, i.e., between microsocial contracts and the thrust of regulation, diverge, the result is more conflict, inefficiency, and confusion, results that in the end encourage social blowback and threatens even the welfare of investors.
  - Expensive SOX requirements are now encouraging firms to de-list from stock exchanges embodying SOX initiatives, and to shift their ownership structure from publicly-traded to private.

4. Exogenous: Dominant Theories of Competitive Advantage.

- Porter's industry structure viewpoint, and the resource-based view exhibit a deprivation-oriented focus that encourages social blowback.