

efforts, winning first an award from the Scottish Local Authority and then the prestigious European Excellence Award. Their kaizen teams were renamed and made permanent.

**SEE ALSO** *Japanese Management; Lean Manufacturing and Just-in-Time Production; Quality and Total Quality Management; Quality Gurus; Statistical Process Control and Six Sigma*

## BIBLIOGRAPHY

- Aberdeenshire Council. *Kaizen a Model for Continuous Improvement*. International Leading Practices Symposium, 2008.
- Cane, Sheila. *Kaizen Strategies for Winning Through People*. London: Pitman Publishing, 1996.
- "A Change of Pace: Refreshing Continuous Improvement and Developing Leaders at Pace." *Training Journal* (December 2004): 50–52.
- de Jager, B., et al. "Enabling Continuous Improvement: A Case Study of Implementation." *Journal of Manufacturing Technology Management*, 15, no. 4 (2004): 315–324.
- Dessinger, J., and J.L. Moseley. *Confirmative Evaluation: Practical Strategies for Valuing Continuous Improvement*. San Francisco, CA: Pfeiffer, 2004.
- DPA. "Financial Services Continual Improvement Success." *Daniel Penn Associates*, 2001. Available from: <http://www.danielpenn.com/articles/cs>.
- Etienne-Hamilton, E.C. *Operations Strategies for Competitive Advantage: Text and Cases*. Fort Worth, TX: The Dryden Press, 1994.
- Flint, Perry. "Rewired for Success." *Air Transport World* 41, no. 9 (2004): 38–39.
- Jorgensen, F., H. Boer, and F. Gertsen. "Development of a Team-Based Framework for Conducting Self-Assessment of Continuous Improvement." *Journal of Manufacturing Technology Management*, 15, no. 4 (2004): 343–349.
- Maurer, Robert. *One Small Step Can Change Your Life: The Kaizen Way*. New York: Workman, 2004.
- Pereira, Ron. "Two Types of Kaizen." *LSS Academy*, 28 Oct 2007.
- Rijnders, S., and H. Boer. "A Typology of Continuous Improvement Implementation Processes." *Knowledge and Process Management* 11, no. 4 (October-December 2004): 283–296.
- Rogers, Mike. *CIMA Managerial Studies: Be Prepared*. Butterworth-Heinemann, 2008.
- Stevenson, William J. *Production Operations Management*. 6th ed. Boston, MA: Irwin McGraw-Hill, 1999.
- Stonebraker, Peter W., and G. Keong Leong. *Operations Strategy: Focusing Competitive Excellence*. Boston, MA: Allyn and Bacon, 1994.

## CORPORATE GOVERNANCE

Corporate governance is the responsibility of a firm's board of directors. While management runs the company and oversees day-to-day operations, it is the board of

directors that "governs" the corporations by overseeing management and representing the interests of the firm's shareholders.

By law, a corporation of any size must have a board of directors elected by its shareholders. The directors have a fiduciary duty to the shareholders (who are the corporation's owners), and directors as well as corporate officers can be held liable for failing to meet their fiduciary duties to stockholders. A passive board can get into trouble by relying on an influential CEO.

Investors and the public are particularly interested in the financial reports that publicly-traded companies release, and boards of directors of these companies have a legal obligation to ensure that these reports are fair and accurate. Recent business failures, auditor malfeasance, and material deficiencies in financial disclosures, however, have caused a serious erosion of public confidence in the financial reporting of these companies.

## SARBANES-OXLEY

Several major cases of corporate fraud and accounting scandal occurred in the early 2000s, including the widely-known cases of Enron, Tyco, and WorldCom. This sudden surge in board misconduct led to investor doubt, the loss of billions in market capital, and harsh penalties for the company leaders found responsible. There was a general outcry for new standards and more specific laws.

Consequently, Congress, with nearly no dissenting votes, enacted the Sarbanes-Oxley Act of 2002, named after Democrat Senator Paul Sarbanes and Republican Representative Michael Oxley, who sponsored the legislation. Common law has traditionally held that corporate directors have a primary fiduciary duty to the corporation and a secondary duty the shareholders. Sarbanes-Oxley, referred to as SOX or Sarbox, has essentially made directors primarily responsible to the shareholders.

There are several specific requirements in SOX's eleven titles, most aimed at corporate boards and the way they authorize financial information. In addition to harsher penalties for corporate fraud and white collar crime, SOX also addresses the authorization of company financial reports. The board members reviewing the reports are now required to sign their certification that they have studied the financial reports, that the information within the reports is factual and not misleading, that the data represents the financial state of the company correctly, that analysis of the data has been conducted by the board to prove its accuracy, and that the report gives any information pertaining to fraud or the change of internal controls.

In addition to the authorization requirements, which affected most managers across the nation, SOX requires

publicly held companies to immediately notify the public concerning any drastic changes to their financial state, communicating the information so that it is easy for the investors to understand. These and other compliance laws in SOX make it much more difficult for companies to withhold incriminating data, or to hide fraud in accounting costs, as had been done in the notorious cases.

For altering or intentionally deceiving investigators through financial records, SOX imposes heavy fines and/or up to twenty years imprisonment for the company leaders involved. Accountants—usually from outside the company—who ignore attempts at fraud when auditing receive fines and up to ten years imprisonment.

### KEY GOVERNANCE ISSUES

Historically, corporate boards of directors have had a myriad of duties, most of them set by common law and the corporation's own by-laws. These duties often include: hiring, supervising, and sometimes firing the chief executive officer (CEO); approving major strategic decisions; meeting with shareholders; establishing executive compensation; making decisions about mergers and acquisitions; assessing the viability of potential takeover bids; taking action if the corporation fails; overseeing financial reporting and audits; nominating board candidates; and refining board rules and policies.

One of the most difficult governance duties of the board of directors is the removal of the firm's CEO. This can occur when the board, representing the interests of the shareholders, disagrees with the strategic direction being pursued by the CEO, or if they merely want to show they are "doing their duty" as board members. For example, when Carly Fiorina was ousted as CEO of Hewlett-Packard (HP) in 2005, she was viewed by many to be hard-driving and fearless. The HP board of directors, however, had grown increasingly uncomfortable with her inability to deliver the profits that she promised she was going to deliver. Her refusal to relinquish some operating control, or to make any changes that the board requested, led to her downfall during a period of low profits and falling stock prices.

One measure of good governance is whether the company has a CEO who can maximize the company's performance. Whereas part of the governance function of the board of directors is to select the firm's CEO, another is to endorse the CEO's strategy—if it is the right one. For example, boards can support the CEO's strategic direction by endorsing proposed acquisitions. It can push the CEO to accomplish even more by encouraging him or her to think more broadly or by setting higher sales targets. The board can also support the CEO's leadership by making sure that the CEO is able to put together a strong management team to achieve those goals. In some

cases the following CEO will be recruited from the management team built by the present CEO.

Another difficult time for boards occurs when the firm is the target of a takeover attempt. It is vitally important at such a time that the board have a clear sense of the value of the firm and that it is enabled to fully evaluate takeover offers. During a takeover it is the board's responsibility to accept or reject offers, and in so doing it must represent the shareholders' interests when negotiating the sale of the firm.

### GOVERNANCE COMMITTEES

Boards often administer their governance responsibilities by establishing committees to oversee different areas of concern. Typical committees include audit, nominating, and compensation committees. This is largely in line with U.S. regulatory guidance. On August 16, 2002, the Securities and Exchange Commission (SEC) updated earlier proposals related to corporate governance that would recommend, but not mandate, that boards establish three oversight committees: a nominating committee, a compensation committee, and an audit committee. The SEC recommended that these oversight committees be composed entirely of independent directors.

Each committee oversees a specific area of corporate governance and reports to the full board. The nominating committee's area of oversight consists of issues related to management succession, including the CEO, and to the composition of the board of directors. The compensation committee oversees compensation of the firm's CEO and its officers, as well as director compensation. The audit committee is concerned with the company's financial condition, internal accounting controls, and issues relating to the firm's audit by an independent auditor.

Almost all publicly held corporate entities in the United States have an audit committee. Since 1978, the New York Stock Exchange (NYSE) has required corporations to have audit committees composed entirely of independent outside directors as a condition for being listed. The audit committees of corporate boards of directors are generally expected to serve as watchdogs for the investors and the creditors. Audit committees are expected to protect the interests of both investors and creditors, as well as steward corporate accountability. Moreover, audit committees should make sure that management, the internal auditors, and the external auditors understand that the committee will hold them accountable for their actions (and in some cases, inaction).

The independent audit committee plays a key role in stewardship of the corporation it serves. The audit committee should help ensure that the financial statements are fairly stated, the internal controls are operating effectively, management risk is being reduced, and new processes are

minimizing risks. Moreover, the audit committee members should be independent of management and maintain a close working relationship with the independent auditors.

In an article in the *Pennsylvania CPA Journal*, author John M. Fleming sets forth the primary responsibilities of the corporate audit committee: (1) Evaluating the processes in place to assess company risks and the effectiveness of internal controls, and assisting management in improving these processes where necessary; (2) monitoring the financial reporting process both internally and externally; and (3) monitoring and evaluating the performance of internal and external auditors.

A board will sometimes establish a fourth committee, the governance committee. The governance committee is concerned with overseeing how the company is being run, including evaluation of both management and the board of directors. In some cases the nominating committee will evolve into, or function as, a governance committee.

#### ACTIVE GOVERNANCE

Historically, corporate boards have been described as either active or passive. Some corporate CEOs relished having what they thought were “rubber stamp” boards of directors who would approve virtually any actions they chose to pursue. Sarbanes-Oxley has dramatically changed that dynamic. Corporate directors must now be much more independent, and their legal liability to shareholders has increased significantly.

One example in which a traditionally “quiet” board stepped up and became more active occurred with the Walt Disney Company. For years, Michael Eisner ruled the Disney empire with an allegedly brutal iron fist. After Roy E. Disney, Walt Disney’s nephew, led a shareholder revolt of sorts and complained that investor votes were being ignored or circumvented, the Walt Disney Company board of directors finally decided to step in. In early 2004, the board took the chairmanship away from Eisner after more than 45 percent of votes cast at the company’s annual meeting opposed his board re-election. It was a resounding vote of no confidence. But the board then chose an Eisner ally, former U.S. Senator George Mitchell, as chairman, over the objections of several larger shareholders. Ironically, a year later, Eisner was easily re-elected to the board, with only 8.6 percent of voters withholding their support for him.

Boards can take simpler steps to ensure they are not passive without voting out the CEO. They can establish a non-executive chairman, a chairperson who is separate from the CEO. The board can also staff all board committees with independent outside directors, except the president and CEO.

#### ENVIRONMENTAL GOVERNANCE

Lobbyist groups and investors who are concerned with environmental responsibility are becoming increasingly involved in influencing companies whose practices are seen as environmentally unfriendly. The new, easier access to information encouraged by such legislation as Sarbanes-Oxley gives such interested groups the tools to make a difference in the business market. Companies, seeing the short- and long-term benefits to be gained by practicing environmental responsibility, are willingly changing policy in new marketing strategies and creating initiatives to become more “green” and environmentally conscious.

Some corporate boards choose to publish their new policies concerning greener ways of production and manufacturing, or like Advanced Micro Devices, Inc., to create a commitment plan for climate protection. Others, such as Disney, create a separate environmental mission statement. By investing in sustainability and environmentally friendly systems, organizations are finding ways to cut costs, create new goals for themselves, launch new marketing endeavors, and even produce revolutionary technology.

According to a 2007 article *The Encyclopedia of Earth* by Brian Roach, between the years 1995 and 2003, socially responsible investing by corporations grew approximately 40 percent faster than overall investment, and by 2003 approximately 11 percent of United States investments pertained to environmentally conscious activities.

The environmental policies boards are creating pertain to many different areas, and while many concepts are unique to the company that produces them, some are more general. For instance, *eco-labeling* is a common practice; this is the labeling of products to include pertinent environmental information. If a bottle is made of recyclable material, the company can include an eco-label noting the information, making their product more desirable in environmentally conscious markets. If food is grown naturally, or if wood is produced locally, eco-labels can indicate it for the benefit of interested customers. Eco-labels can also include information on the environmental impact the product had in being manufactured, or will have on being consumed.

Examples of corporate environmental responsibility are becoming increasingly common. In Europe, the European Automobile Industry Association agreed to try to reduce their emissions to 140 g per kilometer by 2008. Car companies developed light, small cars such as the SMART car developed by Daimler-Chrysler. In 2007, the British retailer Marks and Spencer revealed a five-year plan, estimated to cost 200 millions pounds, to make the company carbon neutral. For many companies, carbon

footprints have become an area of concern, and reducing carbon output has turned into a strong initiative for many organizations.

In America, companies such as Kimberly-Clark are working on research to develop products that have helpful social and environmental effects. Some, such as 3M, are turning their focus to products that are more environmentally disposable.

### THE ROLE OF INVESTOR ACTIVISM

Finding qualified people to serve on corporate boards of directors can be a challenging task. Corporate board members are learning in the current legal environment that serving on such board can open them to a wide range of legal liability issues. The reforms of Sarbanes-Oxley and the SEC all seem well-intended, but will they make a difference for board members who get in over their heads or choose to look away?

Many critics argue that the proposed and enacted reforms do little to solve the real problems that exist with corporate boards. For example, one issue that has been repeatedly raised is the fact that corporate boards tend to meet only a couple of times a year. Yet it is further argued that more frequent meetings do little to solve the major problem, which is the fact that most corporate board members do not have enough access to information to fulfill their duties of stewardship to the shareholders.

Another issue that has been raised after continuous corporate failures revolves around the financial knowledge and competence of corporate board members. One proposed reform to remedy this problem has been to offer more generous pay for corporate board members, particularly those who serve on audit committees. The theory behind the increased pay is that it would help attract more chief financial officers and former chief executive officers from major accounting firms to serve on audit committees.

Proponents of such a move argue that former CFOs and CEOs are ideal audit committee members. But, there remains a limited pool of these professionals available to serve on audit committees. Furthermore, increased disclosure requirements are likely to raise liability for individual audit committee members, thus having a negative impact on their willingness to serve. Increased compensation may not persuade highly-qualified potential committee members to accept the burdensome legal responsibility of vouching for a multinational company's complex and intricate accounting system.

Finally, it is important to realize that having the best and most qualified corporate board of directors is no guarantee that financial reporting or other problems will not occur. Many of the corporate failures, large and small, that occur every year have arisen as a result of inattention,

reckless disregard, or malfeasance. While some of the new and proposed regulations may address specific issues that have occurred in certain situations, they will never fully compensate for flaws in human nature. Many corporate failures would still have occurred under the new rules set by Congress and the SEC if board members found ways to ignore or circumvent them. As long as human judgment and discretion is permitted to operate within the corporate board function, there is room for error and wrongdoing.

### BIBLIOGRAPHY

- Byron, Ellen. "Corporate Governance (A Special Report): Managers: Keep Out: Independent Directors Have a Lot More Power These Days, and a Lot More Responsibility." *Wall Street Journal*, 21 June 2004.
- Fiksel, Joseph, Robert Axelrod, and Susan Russell. "Inside Out: Sustainability Communication Begins in the Workplace." *Green@work* Summer, 2005.
- Fleming, John M. "Audit Committee: Roles, Responsibilities, and Performance." *Pennsylvania CPA Journal* 73 (Summer 2002): 29–32.
- Anthony, Henry. *Understanding Strategic Management* Oxford University Press, 2008.
- Hymowitz, Carol. "Corporate Governance (A Special Report); Experiments in Corporate Governance: Finding the Right Way to Improve Board Oversight Isn't Easy; But Plenty of Companies Are Trying." *Wall Street Journal*, 21 June 2004.
- Karmel, Roberta S. "Should a Duty to the Corporation Be Imposed on Institutional Shareholders?" *The Business Lawyer* 60 (November 2004): 1.
- Levy, David, and Peter Newell. *The Business of Global Environment Governance*. MIT Press, 2004.
- Pagella, Sasha. "2008 Proxy Season Foresights #9: The Environmental Agenda Heats Up." *The Corporate Library* April 14, 2008.
- Raber, Roger. "What Has Really Changed in the American Boardroom." *Community Banker* 13 (October 2004): 60.
- Saporito, Bill. "Why Carly's Out." *Time*, 21 February 2005, 34.
- "Sarbanes-Oxley Compliance." *Soxlaw.com* 2003.
- Sherman, Jay. "Eisner Still in Charge." *Television Week*, 14 February 2005, 3.
- "S&P, Hawkamah Launch Environmental Corporate governance and Sustainability Indices for Mena Markets" *AME Info*. Available from: <http://www.ameinfo.com/153610.html>.
- U.S. Securities and Exchange Commission. "NASD and NYSE Rulemaking: Relating to Corporate Governance." Available from: <http://www.sec.gov/rules/sro/34-48745.htm>.

## CORPORATE SOCIAL RESPONSIBILITY

In their 2003 book, *Business and Society: Ethics and Stakeholder Management*, Carrol and Bucholtz describe corporate social responsibility (CSR) as the "economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time." The concept of