Good Corporate Management: What, Why and How?

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Crises and Management

• U.S. has suffered two crises in different sectors of its economy during the past eight years: business corporations (Enron, WorldCom, etc.) in 2000-1 and financial corporations in 2008-9
• In both cases criteria for judging the success of management and governance of these corporations are linked to these failures
• In these few minutes I shall outline a perspective on the nature of corporations, a criterion for judging the success of their management, and an approach to measuring it
• This perspective and criterion are already more familiar in Japan, and their use will help avert future crises
The Outline

- **Organizations**: alliances among various people, each pursuing self-interest broadly defined
- **Culture of an organization**: the shared expectations of the behavior of one another held by its participants
- **Good management**: balance or match between the culture (mutual expectations) and self-interest of the participants
- **Why Good management?** It makes all participants better off
- **Elements of Good management**: balance among regulation, market forces, and social norms
- **Threats**: changes in environment, markets, self-interest
- **Strategic Management**: anticipating and addressing the threats
- **Organization and Society**: evaluation of organizations and their management by the sum of surplus received by all participants
- **No Holy Grail**: Good management is a constant struggle to maintain balance under ever-changing conditions; a journey, not a destination
Alliance or Contract

- Each participant promises to contribute resources
- In exchange for the promise of inducements
- A participant enters the alliance if expected inducement is more than the opportunity cost of the contribution
- To succeed, an organization must have a set of agent, contracts, and production technology such that it can simultaneously satisfy the contracts of all participants
- Otherwise, dissatisfied agents abandon the alliance
- Organization collapses unless an alternative set of contracts and participants that satisfies the condition is assembled
Organization as an Alliance among People

- Managers
- Shareholder
- Creditors
- Employees
- Customers
- Auditors
- Government
- Vendors
Examples of Contracts

• Contract is a mutual expectation or understanding among agents
• Lunch date
• This symposium
• Promising a delivery schedule to customer
• Explicit or implicit promise of relevant action
• Legal enforceability or written form not necessary
• Social conventions play an important role
Control in Organizations

• Operating mechanism for contracts
• Necessary to assemble, implement, enforce, modify and maintain the contract set
• Five functions
  – Measure resource contributions from agents
  – Monitor resource outflows to agents
  – Relate inflow and outflow for each agent
  – Maintain liquidity of factor markets
  – Shared knowledge to facilitate contract renegotiation
Culture of Organizations

- Culture of an organization is the set of shared expectations of one another’s behavior among the members of a group
  - Starting meetings on time
  - Wearing a suit to office
- Culture is developed through social interactions
- Culture is mostly bottom-up, not top-down
- Culture maintained through social, not formal sanctions
- Acculturation of new entrants takes time, making it difficult to maintain an organization’s culture if it expands too rapidly
Good Management

- Criterion for good management derived from the concepts of
  - Organizations as alliances, or sets of contracts,
  - Culture or shared expectations

- An organization or group is managed well when all of its participant find it in their own best interests to do what is expected of them by others in the organization
Matching Expectations and Self-interest

- This is a difficult task for management
- Management can influence but not control expectations of people (a large bonus)
- Every action, event, and outcome affects peoples’ expectations of the future
- Individual self-interest is not always known to the manager
- Both expectations as well as self-interest change continually
Why Care for Good Management

• Good management is a more reliable route to
  – Creation of wealth
  – A satisfying work environment, and
  – A better life for all participants.

• On occasion, individuals may gain advantage for themselves by surprising others (i.e., behave in ways not expected of them)

• Such advantages tend to be ephemeral
  – Create personal and social anxiety and disruption
  – Are ultimately counterproductive.
Discipline for Good Management: Laws, Markets and Social

• Three sources of discipline for management
  – Government (laws and regulations)
  – Market forces
  – Social norms

• A careful balance among them is necessary for good management

• Total dependence on any one or two is unlikely to provide a satisfactory outcome because all three are susceptible to failure

• Social norms are internalized in a community and may appear as self-discipline
Threats to Good Management

• Established systems of good management threatened by
  – Changes in technology
  – Changes in markets in which the organization transacts, and
  – Self-interest of the participants
• A contract set which is in good management today, may not be in good management tomorrow if the conditions change
• People for who such changes render participation in the alliance disadvantageous seek to leave.
• If these people are essential to the alliance, their departure may make the alliance undesirable for others too, possibility of cascading departures and collapse of the organization
• A fixed set of contracts cannot remain in balance for long (expectational equilibrium) except by sheer chance
• Risks of misunderstanding, miscalculation, misrepresentation and coercion
Functions of Top Management

• Various labels for this function (long term planning, strategic management, etc.):
  – Monitor your environment
  – Anticipate changes in factor and product markets
  – Redesign contracts to be \textit{in} control under the new conditions
  – Renegotiate contracts
  – Communicate and implement new contracts

• Perpetual revision of corporate plans to retain their desirability from the point of view of all participants
Extensive Income as Measure of Good Management

• How to measure the performance of an organization and its management from the point of view of the society?
• Each participant earns an income from participation
• Economic Income or surplus of each participant = (the value of resources received - the opportunity cost of the resources contributed)
• In contrast, traditional income focuses on gross flow of resources to shareholders alone (assumes that all other contributors of resources get zero surplus from the organization)
  – This assumption is neither true in practice, nor desirable in the long run; exclusive pursuit of shareholder interest alone leads to poor management and poor results for the shareholders in the longer run
Economic Income or Surplus to Employees

• Wages, benefits, and enhancement of human capital – opportunity cost of their time
Economic Income or Surplus to Customers

• Value received by the customer - customer’s sacrifice in the form of search, learning, negotiation, payments, settlement of disputes
• Expected PV of benefits to customers from goods received should exceed the PV of sacrifices they make (otherwise they do not buy)
• Includes consequences of the current as well as future transactions (reduction in time, cost, search etc. for later transactions)
Economic Income or Surplus to Government

• Various levels of government provide mostly non-priced services plus some priced goods

• Government’s income or surplus = tax revenues from providing non-priced services plus some fees minus O.C. of resources spent on providing these services

• In this sense, government is like other vendors of private goods and services
Income from the Organization to Community

- Local, national and global
- Most exchanges in form of externalities
- Income from the firm to the community is the sum of net externalities plus the net payments
Income from Organization to Society

- Extensive income is the sum of income to all participants, government, community (including positive and negative externalities)
- Income to shareholder is included in extensive income
- But extensive income (to society as a whole) also includes income to all other parts of society
- Components of extensive income accrue to various participants and serve as guide to their respective decisions
- Extensive income is the appropriate criterion for social policy and decisions, and measure for evaluation of management
- Conceptual acceptance of the idea will help develop the specifics of accounting to measure extensive income
- Fortunately, in Japan, this broader criterion is better support
No Panacea for Good Management

- Good management is a constant struggle to design and redesign the organization’s alliance in response to changes in its environment
- There is no single solution that fits all
- No solution remains effective for long.
- Ensuring that the self-interest of each participant is aligned with what he or she is supposed to do should be the top priority of the directors and senior management of organizations
- History shows that good management is a journey, not a destination, requires constant vigilance by all participants
Thank You!

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