CORPORATE GOVERNANCE AND COMPETITIVE CAPABILITY IN SERBIAN COMPANIES

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ABSTRACT

In the field of corporate governance, the organizational capability is seen as authority-based and resource-based capability. The composition of board and its responsibilities, balanced relations with the top management, defined policies and procedures of information access and adopted stakeholder approach in corporate governance are the relevant characteristics for organizational learning. The aim of the article is to examine the role of the corporate governance in the process of organizational learning in order to achieve the competitive advantage. The article will explore the practice of Serbian companies with regards to the nature and the character of corporate governance and its role in creation and dispersion of knowledge. The received results show disadvantages of the development in corporate governance, which is the key to forming an optimal organizational system of learning. The final results may prove extremely useful for the improvement of the governance and the process of organizational learning.

Keywords: corporate governance, competitive capability, knowledge, organizational learning, competitive advantage.
INTRODUCTION

Corporate governance has a two-fold meaning. One relates to the relationship between the company and its stakeholders, including shareholders, employees, creditors, competitors, customers, etc. The other meaning indicates that the corporate governance is a mechanism for checking and monitoring the behavior of the top management. In developed economies, corporate governance has two main aims: on the one hand, it aims to prevent recurrence of corporate scandals; and on the other, to strengthen corporate competitiveness. The literature referring to strategy presents corporate governance as an important factor affecting the performance and long-term survival of the company.

The key role of the Board of directors is to ensure the prosperity of the company through the directing the operations of the company collectively, and by satisfying the interests of its shareholders and stakeholders. The Board can help by focusing on determining the vision, mission and values to be promoted within the company. In addition, the Board helps the company by setting up strategies and plans that support the company and by providing adequate organizational structure and capability of the company to implement appropriate strategies. Similarly, its vital functions are to delegate the authority among the management, to monitor and evaluate the policy of the implementation of strategies and business plans, while maintaining its own accountability towards shareholders and other relevant stakeholders.

Strategic capability of the company is reflected in the resources, competencies and dynamic capabilities, continuous improvement of cost efficiency, organizational knowledge and strategic skills, diagnosis of strategic capability and development of strategic capabilities. Capabilities of a company are taking many forms, and a review of some relevant literature shows that they can be classified into four main categories: position-based, efficiency-based, knowledge-based and authority-based capabilities. In accordance with the traditions of classical economics, position-based ability considers barriers to entry, the relative negotiation power of participants, cost differentials and imperfect market conditions as dependent sources of a company’s capability. The efficiency-based capability can be classified as a subtype of the position-based capability.

Sustainable competitiveness is achieved through the development of durable strategic capabilities that provide a long-term advantage. In the rapidly changing environment the emphasis is placed on the organizational capability which represents the capability of a company to change, to innovate, to be flexible, to adapt and to learn.
COMPETITIVE CAPABILITY BASED ON RESOURCES

Resource-based view of strategy is reflected in the competitive ability, which stems from the distinctive organizational capabilities. This is the answer to the question why some businesses achieve extraordinary profits compared to others in the same industry. The resources or skills of the successful companies enable them to: produce at lower costs or generate a superior product or service at a standard cost. Resource-based views of a firm consider the company to be a bundle of heterogeneous resources which are partly mobile. A sustainable competitive advantage is derived from the possession and use of valuable, rare irreplaceable resources, which are difficult or impossible to copy.

According to Oliver (1998), the process of allocating resources can be crucial for sustainable competitive advantage. It is pointed out that this depends on the speed at which the new capabilities can be integrated in the existing organizational knowledge and on how successful new and old knowledge are coordinated to achieve new performances. The capability is defined as “a set of complementary resources, administrative skills and practices, and assets with a merit to generate adaptive and valuable outputs” (Miller, 2003, p. 964). Capability comprehended in this way is the main driver of competitive behavior in the resource-based theory of corporate governance, which includes stakeholder theory.

COMPETITIVE CAPABILITIES BASED ON KNOWLEDGE

In an economy based on capital, those who manage capital better than the competition secure victory on the market, while the development of the movement towards a knowledge-based economy, gives rise to expectations that those who manage knowledge better than their competitors have the advantage. Capability is a platform that contributes to the emerging strategy and supports it in the knowledge economy. It is a company that can recognize the changes in the market, that can develop appropriate business strategies, build capabilities which support it, that will be the company that will prosper. Managing relevant variables as well as creating the ability to become the primary strategic tool, which will result in sustainable competitive advantage is a great challenge for managers.

Capabilities are manifested in different forms. Thus, they may in essence be based on knowledge, or other resources. Resources based on knowledge can explain why the company exists and why it develops certain internal structures. On the other hand, corporate governance can affect the production of knowledge. In a competitive environment, the structure of the company can be seen as the result of three imperatives: 1) the company must produce knowledge in their own framework 2) the company must transfer and
disseminate knowledge within itself 3) the company must prevent the illegal transfer of knowledge outside of itself (Ashish, et al, 2001 and Foss 2005). Companies will try to maximize the use of knowledge resources in order to boost profits. They will also try to reduce the risk of leakage and gobbling of the knowledge. In this regard, the company creates certain organizational arrangements, such as steeper hierarchy (usually in companies of mass production), or flatter hierarchy (high-tech companies), then it adopts certain systems of compensation and engagement in certain types of business transactions. This explains why a company adopts centralized or flatter hierarchy. These types of hierarchy allow the saving of expensive knowledge located in individuals.

Knowledge is undoubtedly the property of the individual, and trust plays a major role in the activities of knowledge management (Ngah, 2009). The development of trust among employees is a crucial issue in ensuring the development of organizational knowledge, which is critical for continuous innovation (Chowdhury, 2005). It is very important for the flow of knowledge within the organization (Yli-Renko, et al. 2001). Knowledge can be defined as the human ability to provide data and information useful for decision-making processes (Laudon and Laudon, 2004) and can be divided into: explicit, referring to organizational culture, which shows the way relations function in the organization based on organizational policies and procedures; component knowledge, which can range from technical know-how to highly systematic knowledge, and it is a part of explicit knowledge; tacit, which is based on personal knowledge, experience and judgement, and contributes to the common perception of the ethical characteristics of an organization (Petrović-Lazarević, 2005).

COMPETITIVE CAPABILITIES BASED ON AUTHORITY

The largest number of concepts and studies that address the resource-based governance are closely related to the hierarchical structure of the firm. Inderst et al. (2003) maintains that the hierarchy of the firm can keep resources focused on the task and how it creates skills and innovation. An additional level of hierarchy is needed for successful coordination of various internal specialized tasks that are not fulfilled by other companies. The authority which is embedded in the hierarchical structure allows the firm to create sufficient capacity to deal with business uncertainty. In addition to the knowledge-based capability, the authority-based capability can complement internal capability. The authority-based capability of a company is reflected in:

(1) The ownership structure, whose function is to overcome the problem of the legal protection of investors. In developed countries, a high level of corporate governance is
negatively correlated with property concentration, and if the state protects the rights of foreign investors, indicating the quality of corporate governance, then small investors will be more willing to buy stock that will lead to the process against the concentration of ownership. However, the research conducted in Russia indicates that, in that country, good corporate governance is positively correlated with a high concentration of ownership. That is because, in order to institute new corporate governance, the insiders, being the dominant shareholders, must be interested in the welfare of the company, and increasing the number of shares in their own hands is the best way to do so. When asked how the diversity of ownership structure affects the type and intensity of innovation activities in a company, the authors give various answers. In this respect, Lazonick and O'Sullivan (2000), favoring the resource-based viewpoint of the company, bring together the concept of corporate governance and economic performance, strategic management and organizational learning in an innovative company. They distinguish three institutional conditions for innovation: the financial commitment, organizational integration and strategic control. Lazonick, among the conditions for innovation, give priority to organizational integration. He points out that, “contrary to a common belief, ...form of firm ownership is not the critical issue for understanding the type of strategic control that supports innovative enterprise” (Lazonick, 2003, p. 9), suggesting that the focus is on the ability and incentives of managers who exercise strategic control.

(2) Duality of the CEO, a phenomenon when a firm’s Chief Executive Officer also has the role of Chairmen of the Board of Directors. The Anglo-Saxon model of corporate governance, which is predominantly the outsider model, insists on the separation of the two functions; in the Continental law, however, which mostly accepts the insider model, based on relevant regulations, the unification of these functions in one person, the so called duality, is usually present. The advantage of having separate bearers of these functions is the potentially objective control and supervision of the CEO by the board, while the advantage of having a unique bearer of the functions is reflected in a greater operationalization and freedom of action. The latter variant is advocated by the devotees of service and stakeholder theories of corporate governance.

Although the Board of Directors plays a central role in corporate governance, research results show that they are mostly engaged in the supervisory function and that they almost always vote in accordance with the proposal of the CEO. The participation of the board in the formulation of strategies enables them to influence the process of organizational learning, as follows:
It influences the organizational processes of anticipation, interpretation, integration, and institutionalization by balancing the feed-forward and feed-back learning (Crossan, et al., 1999);

By positioning and dismissing top managers, and giving them basic guidelines for their work, the board directly manages strategic cognitive structures.

Outsiders (vis-à-vis insiders) - The assumption is that the number of non-executive directors, who should be experts (i.e. skilled in specific areas important for making adequate decisions at the board of directors' meetings) and independent directors of the board - the board of directors, provides a guarantee that good decisions will be made; decisions of the kind that would bring positive results and, ultimately, profit to the company thus satisfying the interests of relevant stakeholders. Boone, et al. (2007), finds that the optimal composition of the board for certain categories of companies determines the ability of firms to survive.

There are some other, opposite views, (Papania, 2009), according to which there is no standard effective board structure, because the identification and use of strategic possibilities cannot be achieved through a simple formula of the recommended ratio of executive to non-executive board members. However, adapting the structure of the board and the strategic role that the board plays in the management of external relations and development of internal skills, it can significantly affect the company's ability to survive and achieve competitive advantage.

There is also a view that point out that external members of the board could bring positive effects to corporate results because their personal career advancement does not depend on their colleagues' advancement within the board and CEO. Due to their specific knowledge and experience, they contribute to increasing human and social capital of the board and are able to advise management regarding the strategic decisions such as taking the risk of innovative activities (Kor and Sundaramurthy, 2009, Charter and Lorsch, 2004, Bailey and Helfat, 2003).

In contrast to the positive view to the role of external directors, there are researchers who perceive the presence of external directors in negative connotation, i.e., claiming that external directors can weaken corporate performance. These researchers find that outside directors are less informed about the internal processes and therefore they may be less able to assess the long-term value of the activities of executive directors. According to Hermalin and Weisbach (1998) CEO tries to influence the appointment of external members of the board, which is manifested in practice as the appointment of their friends, resulting in a less intensive monitoring of managers. Conyon and Read (2006) argue that managers have an incentive to take more mandates on boards, due to the additional prestige, extra pay etc.
This all leads to the phenomenon of an overworked director, too busy to devote enough time to matters of the boards to which they are supposed to give their optimal services.

We can share the opinions of those authors who concluded that the board with a relatively high diversity in its composition is more likely to increase strategic change than those that are relatively homogeneous. Furthermore, boards that accept the stakeholder access to corporate governance, trying to satisfy the interests of the wider range of stakeholders, are potentially interested in implementing a broader range of knowledge in developing this strategy, all this in relation to boards that seek solely to maximize shareholders value (Ingley and Wu, 2007).

**THE ROLE OF CORPORATE GOVERNANCE IN CREATION OF KNOWLEDGE**

**METHODODOLOGY AND RESULTS OF THE RESEARCH**

The main research question refers to the problem of influence that the nature and character of corporate governance have in the context of creating competitive capabilities through improved knowledge of the company. Other questions refer to the following:

The influence that the board structure, the roles of its members and the improvement of the process of decision-making have on the process of organizational learning;

The influence that the board, in the context of good corporate governance, has on the improvement of the process of organizational learning as a key source of sustainable competitive advantage.

In order to answer the above questions we have used the survey as a method of research. The nature and character of the questionnaires were tailored to the requirements of the research. The questionnaire consists of twenty-six questions intended for managers and board members. It was forwarded to fifty companies of various sizes. The answers were given by ten small and medium-sized companies in Serbia. The questionnaire is used for defining the perception of corporate governance and its role in the process of organizational learning in order to achieve comparative advantage, as a prerequisite for achieving the company's competitive advantage. The questionnaire consists of four parts:

- the first part of the questionnaire refers to the structure of the board of directors, the roles its members have, and the improvement of the decision making process;
- the second part of the questionnaire refers to the key roles of the board of directors;
- the third part refers to the board of directors in the context of good corporate governance;
• The last part deals with the board of directors and capabilities of knowledge management.

Respondents rated each question on a scale 1-7, 1 for the best and 7 for the worst. The mean of all data ranges from 2.6 for the structure of the board, to 4.5 when it comes to the board of directors and corporate governance. The research results can be summarized in a few conclusions.

First, the average number of the board members of the studied companies is 7.2, where the average number full time employees is 4.8 (viz. as executive directors), while the number of members engaged in a contract is 2.4, out of which 1.9 members have the independent status. Therefore, the presence of non-executive members was still significantly lower than that of executive members. This does not necessarily determine the quality of corporate governance, but there is a tendency towards the view that corporate governance would be better if the board of directors had more non-executive than executive members, among other things, because of the potential of new knowledge that they may bring into the company.

Second, the average age structure of board members is 44.4 years which is much lower than the age structure found in the research conducted in the European Union, which is 58.3 years. The gender structure shows that there are 71.30% male members of the boards, while women represent 28.96%, while 20% of the companies has no women representatives in the boards of directors (46.00% of European companies still have no women representatives on the board of directors) (Albert-Roulhac, C., and Breen, P., 2005).

Third, the role of the board in the improving of decision-making process was rated 2.6, and the grades that were offered by the questionnaire ranged from 1 (best) to 7 (worst), which means that the score is above average.

Fourth, the key functions that the board performs, such as the knowledge of the vision, mission, strategy of the company, the implementation of policies related to talent development, the improvement of internal information systems, etc., i.e. the degree of their realization has the average rating of 3.5.

Fifth, all the tests included in the company have responded to the question of whether they think that good corporate governance is obligatory for a successful competition in today's markets. The key benefits of good corporate governance, which are perceived as the most important, are: competitive advantage (1.9), improved resource management (2.8), increased profitability (3.1), while the improved relations with stakeholders take the last
place (6.1). This could lead to the conclusion that, regarding the function of achieving a competitive advantage in the market, there is a lack of understanding of the importance of stakeholders, both in terms of the need to meet their interests, and in terms of respecting them when creating strategies of companies.

Sixth, in the area of distinctive characteristics that, in their opinion, make them successful as competitors, the companies gave the highest marks to an attractive price - 2.7, and the worst mark to social and ethical responsibility of the company - 5.4. That could mean that the companies have shown a low level of knowledge about the important role of a socially responsible behavior.

Seventh, the board's ability to manage knowledge is given an average of 3.6. The answer to the question posed to this group whether their company realizes the process of integrating different sources and types of knowledge was below average rating 4.4. The question whether your company uses a team-based method for decision-making, gave the average rating of 4.6. The question whether your company carries out the procedure of bilateral communication between management and staff, respondents gave an average rating of 4.5.

Eight, the question whether the company has a direct cooperation with stakeholders, especially with universities and higher schools, had an average rating of 3.3.

CONCLUSIONS

We think that the number of board members and their age structure is basically an acceptable starting point of the composition of the board in terms of the prerequisites for good corporate governance, while the gender structure in this regard could be improved. A disturbing fact is that the average number of non-executive board members compared to the number of the executive ones is two times lower. We can conclude that the role of board members in the improving decision-making process is satisfactory, in the sense that it is above the reported average marks, that their role is clearly defined, that they bring valuable skills, knowledge and experience to the company, that they come to the meetings prepared and that they make decisions on the basis of an argumentative and constructive discussion. The boards of directors have expressed awareness that good corporate governance is an "obligation" for successful competition in today's markets.

The achievement of the key functions of management boards is on average well-rated, which indicates that this is an area where, it would be good to work on in practice, especially in terms of raising awareness about the fact that the members of the board and the board as a whole must put the interest of the company above their own interests, in
making decisions; furthermore, that it is necessary to constantly refine the procedures that improve the system of internal information and reporting, as well as the policies related to the development of talents that reflect the needs of companies.

A stand has been made, in terms of the observations of the key benefits of good corporate governance, that there is almost a complete lack of realization of how important it is to improve relations with stakeholders. Hence, we have to conclude that a key element is missing, the element that would decide to accept the stakeholder governance, as a serviceable concept of corporate governance, according to which long-term interests of the company, as well as the efforts to accommodate the interests of all stakeholders in the business venture, are a priority.

For this reason, we express concern that managers might not be encouraged to invest neither in the resources that the company would use in the long run, nor in the knowledge specific to the company. If we add the unsatisfactory involvement of non-executive directors in the composition and operation of boards, we see that one of the key correctives is missing, the one that could contribute to the overcoming of the problem. Both the stakeholder theory and the service theory provide a wider service area representation of the different types of organizational learning, hence we are under the impression that one of the key reasons for inefficiency, poor competitiveness and lack of competitive advantage in the market, lies in our companies. This is underlined by the low level of understanding of the importance of the socially responsible behavior of companies.

Regarding the capability of the board to manage knowledge, despite the reported satisfactory average ratings, the companies should endeavor to improve the processes of integration of the various forms and sources of knowledge, team work (which can contribute to the optimization of decision making by people of different knowledge and experience), and communication between management and staff and direct cooperation with stakeholders.

REFERENCES


