Preface

Begun in 2007, the ‘relational corporate governance approach’ presented in this book is an original contribution in what today is a crowded research space.

Much earlier than the GFC, corporate collapses such as those of Enron and WorldCom in the US and HIH Insurance in Australia, culminating in measures such as the US’s *Sarbanes-Oxley Act* of 2002 and the New York Stock Exchange *Corporate Governance Rules of 2003*, had already put governance practices under the microscope. Consequently, a huge body of legal, economic and econometric literature has grown examining developments in corporate governance codes and their constituent individual governance variables.

This book represents the first stage of the relational approach and lays the foundations for an on-going project. The relational approach is a hybrid. Based on theory and with a springboard from empirical studies, it is both theoretical in explanation and operational in application.

The relational approach is a tool which complements and enhances the explanatory power of the existing principal ‘law and economics’ theories and models of the firm. It maps the effectiveness of corporate governance variables in use in corporate governance codes and laws around the world and assesses reform proposals in the field. The approach can be used by regulators, policy-makers, law reformers and corporate actors and their advisors as a diagnostic tool to analyse the governance health of individual companies and the governance actions required to remedy sub-optimal governance and management arrangements. The principal aim of the relational approach is to describe and evaluate the *interrelationships* between the most significant fields of corporate governance study and practice and the governance variables to which these fields give rise. In this way, the relational approach can be used to make predictions in relation to the relative importance of governance variables *inter se* in reducing (or increasing) agency costs and enhancing (or reducing) the long-term efficiency and survival of the for-profit firm.

The relational approach is built from an artificial environment that simulates the real world sphere of corporate governance and is comprised

of the four Key Fields drawn from the Social Science Research Network (<http://www.ssrn.com/>) electronic library database: (1) application of the principal theories of the firm to the relational approach; (2) ‘autopsies’ of the Enron (and Hastie Group) corporate collapses; (3) comparative international and national corporate governance codes; and (4) empirical studies of the effectiveness of governance variables. From these Key Fields a ‘weighing mechanism’ is constructed comprising four theoretical components.

First, the relational approach introduces a new definition of relational corporate governance known as the ‘three relational axes of good governance’. These three relational axes act like a set of scales to theoretically ‘weigh’ the competing interests of those ‘inside’ the corporation and those ‘outside’. Second, the relational approach establishes a set of eight ‘governance factors’ which are the principal or central themes underlying the four Key Fields. These eight governance factors are the eight most common themes in the relational approach’s simulated representation of real-world corporate governance. The theoretical ‘weighing’ of the governance factors in the three relational axes of good governance is already completed and presented for the reader. Thus the *interrelationships* between the eight governance factors are presented in two diagrams called ‘interrelationship schemes’, one for the shareholder (primacy) model and the other representing the stakeholder model.

For application to real-world governance practice from these interrelationship schemes, the relational approach constructs – for each of 39 governance variables – a ‘relational effect path’ that seeks to explain which governance factors are affected by each governance variable and the direction of the effect.

The interrelationships depicted in a relational effect path for each governance variable are then displayed in operational tables. The Coverage Table (Table 3.1) summarises the relational effect path for each governance variable. In the Relational Proximity Table (Table 3.2), each governance variable is ranked in order of descending relative importance on a new rating scale known as ‘relational proximity’ or ‘*rprox*’. The greater the number of governance factors affected by a governance variable in either direction, then the greater is the relative importance of that variable in affecting agency costs and the long-term efficiency and survival/sustainability of the for-profit corporation.

The significant fields of research in this book – comprising the four Key Fields – are growing constantly. And so, too, must the relational approach grow. But even in a book this size, it is not possible to list all the theoretical literature, empirical studies, codes and other works which

affect the relational approach. So additional references, updates to the research, modifications and additions to the governance variables – and eventually even new Key Fields – will be available electronically on the relational approach companion website (<http://www.relationalcorporategovernance.org>).

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