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CORPORATE GOVERNANCE IN BUILDING AND CONSTRUCTION INDUSTRY

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Abstract

The Building and Construction Industry (BCI) has characteristics that distinguish it from other industries. These are the physical nature of the product, the structure of the industry and the organization of the building and construction process. As a consequence, governance in this industry differs from governance in other industries. The aim of this paper is to point to characteristics of governance in both large and small BCI organizations and suggest in what direction BCI should develop in order to remain globally competitive.

To balance the interest of all stakeholders, a social responsibility committee under the auspices of the board should be established in large BCI organizations. The committee would overview the role of corporate governance and consequently overcome the gap between what organizations present in their organisational mission as their aspiration and intention to achieve, and a community perception of it. On the other hand, if small enterprises follow the process of corporate entrepreneurship management, they would achieve a balance among strategic innovation implementation needs, holding management accountable to the shareholders and financial control. Both activities, in large and small organizations, would contribute to sustaining BCI competitive advantage.

DEPARTMENT OF MANAGEMENT

CORPORATE GOVERNANCE IN BUILDING AND CONSTRUCTION INDUSTRY

INTRODUCTION

In today's literature, governance is often defined as corporate governance, or a system by which business corporations are directed and controlled (Westphal & Zajac, 1997; Meyer, 2000). More specifically, corporate governance is understood in terms of a board of directors who represent shareholders. The directors' role is to attract financial and human capital and "perpetuate itself by generating long-term economic value for its shareholders, while respecting the interest of stakeholders and society as a whole" (Krakovsky, 2002). Corporate governance is also defined as a set of internal rules that indicates the distribution of rights and responsibilities among the management, the board, the shareholders, and other stakeholders (Petrovic-Lazarevic, 2003).

Governance in the BCI is distinguished from the governance in other industries due to characteristics of the industry itself: the specific physical nature of the product, the structure of the industry and the organization of the building and construction process (Petrovic-Lazarevic& Djordjevic, 2002).

The product of BCI is mostly large and expensive and since it is located in a specific geographic area not generally transportable. Buildings and other structures are usually made to meet the requirements of each customer. More precisely, the process of building is known either as a "bespoke" or "off-the peg" process. The bespoke process is designed to meet special customer needs for public, commercial and industrial buildings. The off-the peg process, however, is based not only on erecting buildings for sale for housing, industrial and storage purposes, but also to some extent for educational, social and commercial purposes.

Three separate groups of people are involved in a building process: client, designer and contractor. In the beginning of a building process, the client looks for a designer to do the first phase of a construction project. A chosen designer nominates a tender for selection of equipment for the building work. After the completion and closing of the tender, the client has all the necessary documentation to apply for a bank loan. Then, with the approval of a loan, the financial construction of a project is closed. Having the equipment selected and the financial construction closed, the designer plans the principal activities of the building work. After that, a tender is created for contractors. This usually involves many separate firms. To compete, each contractor follows a legal bidding procedure. With the chosen contractor, the designer makes a detailed final plan of the building work activities. The chosen contractor follows the established plan. Accordingly, the contractor cannot add, change, or reject any of the planned actions.

In the case of off-the-peg buildings, the contractor, who frequently manufactures the major components of a building, employs a designer. Whichever type of building is involved the contractor is largely the one who erects and assembles the products of other industries (Petrovic-Lazarevic, 2002).

BCI is involved in both a private sector and a public sector. In the public sector, the government is a major client who can influence the industry growth directly through commissioning, and indirectly through taxation and legislation. Private sector clients are owner-occupiers, investment groups, developers, churches and leisure organizations.

The work system in BCI is based on projects. Each project incorporates several organizations subcontractors that operate with these own objectives and pressures. In order to organise a building and construction process to function smoothly, the project manager has to control overall costs, time and quality of actions undertaken. Project management activity is temporary, but exposed to a constant pressure of time and cost constraints, competitive tendering and a practice of awarding contracts to the lowest bidder (Holmse, Yesilyurt and Munk, 1999).

BCI firms consist of large organizations with usually over 20 employees and small to medium enterprises (SME) with 5 to 20 employees (Lin and Mills, 2001). Large organisations take the form of a corporation, indicating that corporate governance is an applied management style (Westphal & Zajac, 1997; Meyer, 2000).

Until recently there was a common understanding that BCI SME firms do not have a need for corporate governance. But with the growing pressure to implement innovation through creating new products and processes to be able to respond quickly to fast changing market demands, a need to have a new management style combined with corporate governance appears to be an imperative (McGrath & MacMillan, 2000).

This paper highlights what could possibly be done to improve governance in both large and small BCI organisations to sustain the industry's global competitiveness. In this respect the paper is divided as follows: Part two provides an analysis of current governance in two types of BCI organizations; Part three explains what should be done to improve top management in both large and SME competitiveness; and the Paper ends with concluding remarks and future research directions.

THE CURRENT MODELS OF GOVERNANCE

Australian BCI corporations are turning towards the global market, through a growing number of foreign acquisitions, and employing locals who live close to offshore construction sites. Consequently, they face corporate abuses like any other internationally oriented industry.

In other words, the current structure of corporate governance allows the possibility for key executives to become involved in the fraud (O'Meara, 2003). The structure consists of externals auditors and corporate employees who influence decisions of boards of directors, while corporate executives receive instructions from boards of directors (See Figure 1). Such structure points to a complexity of providing business information and in particular its vulnerability in receiving financial reports from foreign acquisitions (Sama and Shoaf, 2003). In response to recent corporate scandals in the USA and Europe, the need has arisen to change external governance, legislation and regulatory mechanisms by enforcing, first of all, a code of ethics for corporate senior officers, and then adjusting organisational culture (Myers, 2003).

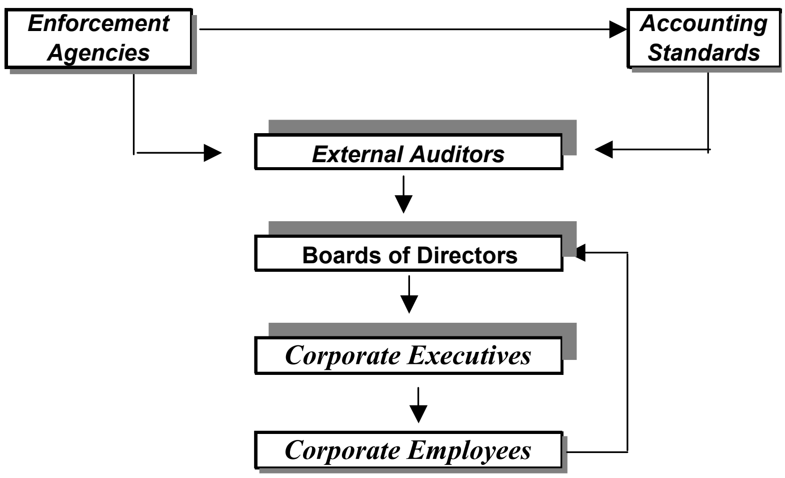

Figure 1: Corporate Governance Structure Source: Sama and Shoaf, 2003

In the BCI in particular, large companies have communication problems with their community. Accordingly, in presenting what organisations are and what they claim they do, there is a great concern as to what extent organizational vision is perceived in the external environment and how much it differs from official organisational aspirations (Purcell, 2003). The situation looks more complicated from the global point of view since inter-stakeholders sometimes do impose goals that jeopardise regional and national values. For example, requirements to increase profit in some cases affect corporations' attempts to improve the communities in which they operate.

Accordingly, a conflict appears in what organizational leaders understand as community requirements for corporations in treating employees, suppliers and customers without prejudice and acting ethically, and local perception of such activities. The conflict can significantly affect organizational competitive advantage.

Although many authors argue that organizational culture is the key to solving ethical problems underlying the role of leadership as a model for ethical reasoning, and that companies do hire ethics consultants and apply code of ethics, there is no evidence of abandoning unethical organizational behaviour (McKendall et al, 2002, Petrovic-Lazarevic, 2001, Victor and Cullen, 1988). In BCI, however, in accordance with an increasing interest of dealing with business ethics, large organisations focus on not only how to satisfy consumer and stakeholders' needs, but also providing an efficient working environment (Coutinho and de Macedo-Soares, 2003).

It appears that corporate governance is in charge of social responsibility when it comes to preserving a healthy external environment. Indeed, Sama and Shoaf (2003) state that only top management can contribute to true ethical progress by communicating the value of ethics to its stakeholders and lower level managers, while outside auditors and the board of directors of the social responsibility committee under the auspice of the board maintain a role in this process through their responsibility to attest to management integrity.

SME governance relies mostly on manager-owners actions. Namely, since manager-owners are contractors and subcontractors, their main concern is to respect time constraints and minimise costs. With growing competition, small BCI organizations face a necessity to search for innovations and explore a price premium or cost advantage (Hill and Jones, 2004). Such activities demand investments and, therefore, impose stakeholders' role as the key players in accomplishing BCI projects. Since completion of BCI projects is sensitive to clients, users and public sector demands, it seems project managers should be more oriented towards a new management style that will significantly include satisfaction of the needs of stakeholders (Karlsen, 2002).

HOW TO IMPROVE GOVERNANCE TO GAIN AND SUSTAIN GLOBAL COMPETITIVENESS

In both large and small BCI organizations the role of stakeholders becomes crucial in improving governance.

In order to balance the interest of all stakeholders a social responsibility of committee under the auspices of the board should be established in large BCI organizations (See Figure 2). The board will overview the role of corporate governance and, consequently, avoid a gap between the vision of an organisation and its perception in a community. The board will also be able to overcome regional differences in values in BCI organizations working off-shore by being responsible for all socially affected and related activities in the organizational external environment. An image of an organization that cares for its environment will, no doubt, contribute to the organization to become better positioned among its clients and users compared to organisations that do not demonstrate high social responsibility.

Top managers create corporate environmental culture as the sum of beliefs and values that reflect the environmental awareness of an organization (Szamosi and Tsolakis, 2003). However, corporate culture changes over time, especially when mergers and acquisitions occur.

According to recent research, a large majority of world wide known organisations state that environmental issues are of extreme importance if an organization is to retain a good position in the global market (Szamosi and Tsolakis, 2003). Hence, environmental leadership must be highlighted in organizational strategy and be presented to all stakeholders. In other words, this indicates that environmental policy should be part of an organisational mission statement. Further to that, Jaques and Clement (1991) argue that responsibility of corporate governance is to deal with environmental strategies. Zairi (2000) suggests that a good image of an organization depends primarily on strong commitment of corporate and social governance to practicing optimal environmental policies.

Since a successful environmental policy has a positive impact on business activities through creating opportunities to gain competitive advantage, we propose the following corporate governance structure for large BCI organizations:

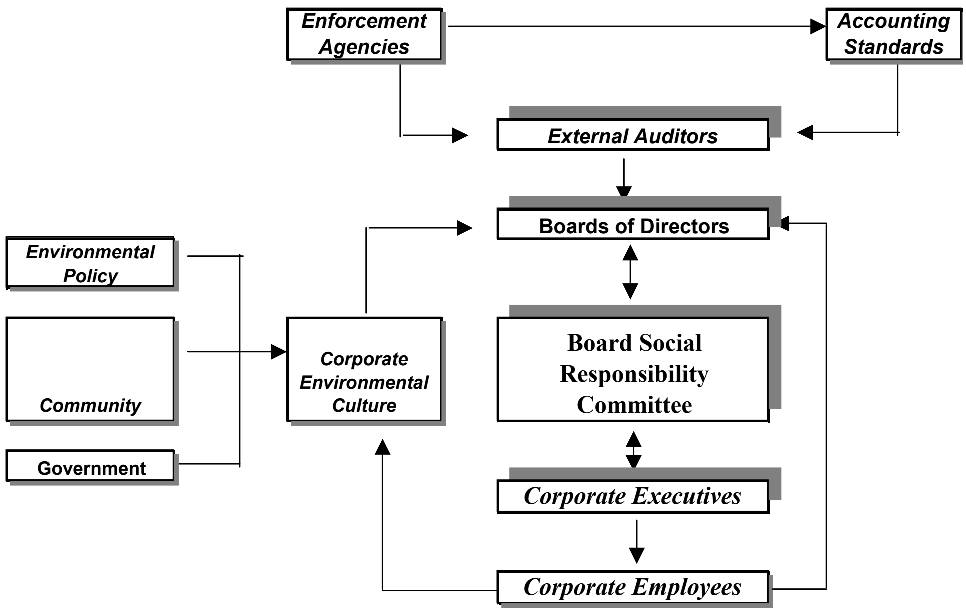

Figure 2: Improved Corporate Governance Structure

In SME the new management style, corporate entrepreneurship management, should impose a balance among strategic innovation implementation needs and holding management accountable to the shareholders and financial control. According to Taylor (2003), by decreasing staff in head office and increasing outsourcing activities, delegating more power to project managers, and training selective executive teams to act as entrepreneurs, the corporate entrepreneurship management will contribute to gaining organisational competitive advantage.

In a corporate entrepreneurship organisation in SME, a project manager is faced with a new task: to pay attention to stakeholders. This task is identified as stakeholder management. If not properly addressed in a project, stakeholder management can cause significant problems. For example, if a project manager is not aware of the main stakeholders, he/she may meet goals, in the completion of the project, that did not comply with the goals of the stakeholders (Meredith & Mantel, 2000). In addition, poor communication and inadequate financial support assigned to the project may cause slowing down of building and construction activities and potential penalties.

To successfully apply stakeholder management, Karlsen (2002) recommends the following steps to be undertaken: initial planning, identification, analysis, communication, action, and follow-up. Initial planning identifies the purpose of the stakeholder management process, and planning activities related to the organization of the process. The second step, stakeholders' identification, is based on interviews with experts and also brain storming at in-group meetings. After that stakeholders should be classified into four categories: supportive (consultants and financial institutions), marginal, non-supportive and mixed blessing (clients, end users and line organization). The fourth step, communication, helps the project manager to find out who the stakeholders are and how thy can influence the project activities. In the action and follow-up step the project manager should encourage cooperation with both supportive stakeholders and mixed blessing stakeholders to cooperate with project management itself. Marginal stakeholders should be monitored to stop decisions that may have a negative influence. Non-supportive stakeholders should be managed to reduce their influence on the project by keeping them satisfied at all times.

CONCLUSION

If large BCI organisations establish a social responsibility committee under the auspice of the board to overview both corporate executives and corporate governance, they would overcome the gap between what they present in their organisational mission as their aspiration and intention, and a community perception of it. They would be able to balance the interests of all stakeholders and consequently sustain competitive advantage. On the other hand, if SME follow the recommended process of corporate entrepreneurship management, they would achieve a balance among strategic innovation implementation needs, and holding management accountable to the shareholders and financial control. That should assist them to remain competitive.

In the future it will be interesting to investigate to what extent a corporate entrepreneurship management style is applied in BCI SME in Australia, and whether it contradicts a project management procedure.

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