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A sustainable future for corporate governance theory and practice

Shann Turnbull[*]

International Institute for self-governance

A B S T R A C T

With this paper we show how the natural "science of control and communications in the animal and the machine" identified by Wiener in 1948 can be applied to social organizations to establish a science of governance. Evidence is provided that current practices are not consistent with the laws of nature or the practices of living things that must become self-regulating and self-governing to exist in dynamic unknowable complex environments. Case studies of stakeholder mutual firms with hundreds of boards show how an ecological form of polycentric decision-making provides: (a) division of powers; (b) checks and balances; (c) distributed intelligence to reduce information overload, and (d) decomposition of decision-making labour to introduce tensions of challenge; (e) a requisite variety of cross checking communication and control channels from stakeholder engagement to improve their integrity; (f) integration of management and governance to further self-regulation and self-governance with: (g) operating advantages such as resiliency, sustainability and wellbeing for firm, its stakeholders and society. The case studies illustrate how ecological governance could reduce the size, scope, cost and intrusiveness of government and their regulators while improving economic efficiency and enriching democracy with widespread citizen stakeholder engagement.

A R T I C L E I N F O

Keywords:
Byte analysis; Chaordic organizations; Corporate governance; Firm performance; Governance science; Holarchy; Multiple boards; Polycentric governance; Risk management; Tensegrity

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1. INTRODUCTION

This paper shows how the natural "science of control and communications in the animal and the machine" identified and described by Wiener (1948) as "cybernetics" can be applied to social organizations to establish a science of governance. The science of governance explains how small-brained creatures with little intelligence can sustain their existence in complex, unknowable dynamic environments while corporations governed by large brained highly intelligent humans cannot.

Adoption of the science of governance provides a basis for achieving a sustainable future for corporate governance theory and practice. However, it means discarding some so called "best governance" practices and turning others upside down. This is because all creatures including humans sustain their existence from augmenting internal top down control and communication channels with bottom up and other channels to create an "ecological" form of "network governance" (Turnbull 2002a).

Network governance arises when a network of boards, and/or control centers internal and/or external to an organization governs its operations. This definition extends the one proposed by Jones, Hesterly & Borgatti (1997) who did not consider the possibility of a division of power occuring within an organisation to create an internal network of control centers to introduce distributed intelligence. Their defintion was limited to networks of firms. This created the problem of identifying the boundaries of firms as raised by Zingales (2000).

Highly successful examples of network governed organisations with over a hundred boards are provided by the John Lewis Partnership in the United Kingdom, VISA International located in the US and the nested networks of networked stakeholder cooperatives located around the town of Mondragon in Spain. Their existance indicates that the introduction of network governance need not necessarily require any change in the law.

Without the introduction of a division of power within an organisation it is not possible to introduce a special type of “ecological” or “holonic” network governance found univerally in social animals (Dunbar 1993). Ecological governance is based on decentralisation as found in the human brain to allow redundancy and so resiliency. As noted by Kurzweil (1999: 84) “None of our individual brain cells is all that important – there is no Chief Executive Officer neuron”.

A fundamental requirement of creatures to exist over generations is the ability to sustain their existance for sufficient time to reproduce themselves in complex, unknowable dynamic environments. To achieve this objective creatures need to be self-regulating and for their social groups to be self-governing.

The ability of firms to become self-regulating would reduce the cost, size and intrusiveness of government and their regulators. For this reason and to follow the imperatives and precendents in the evolution of living things, good governance will be defined as the ability of organisations to further their self-governance. To become self-governing, firms need to become self-regulating to high degree. In this way the regulation of firms becomes largley privatised. Ecological governance becomes a part of “networked regulation” (Tomasic & Akinbami 2011: 242). Offsetting the additional costs of introducing self-regulation and self-governance there are operating and competitive advantages as identified in section four. Operational efficiency is of little importance for a creature or firm that cannot survive.

A practical compelling reason for large complex organisations to adopt ecological governance is provided by the experience of Japanese robot manufacturers. "The reduction in data transmission, and in data complexity, achieved by holonic architecture is prodigeous. Moreover the advantages accumulate as the robotic device gets more complicated." (Mathews 1996: 30). In other words ecological governance allows the data processing by executives and/or board members to be prodigeiously reduced to reduce the risk of physiological and/or neurologcial overloading. There are many additional advantages of ecological governance described in the following sections.

To fully appreciate the advantages of ecological governance an introduction to the science of governance is required. This is undertaken in the following section two. The third section considers how and why so called "best" or "good" governance practices have failed. Section four illustrates network governance with its benefits for various stakeholders outlined in section five. The concluding section six outlines the irrelevancy of dominant corporate governance theories and practices.

2. THE SCIENCE OF GOVERNANCE

Stafford Beer pioneered the application of cybernetics principles to management that became described variously as "operations research", "management cybernetics", "management science" or "system science". As the President of the World Organization of System Science and Cybernetics, Beer informed me in 1996 that neither he nor his colleagues had applied the science of control and communications to the governance of organizations.

From 1970 to 1973 Beer had worked for President Allende in Chile to establish a system of control and communications to operate a socialist economy using Teletype printers. So while Beer had applied the principals of cybernetics to coordinating firms this had been achieved in top down control and communication system as commonly found in hierarchical firms. One widely known contribution of Beer (1985) was his concept of organizing units of a firm into a "viable system" to efficaciously manage complex tasks. This contribution was based on conceptual rather than quantitative cybernetic analysis.

Quantitative analysis of organizations only became possible when technology progressed to allow natural scientists to identify the physiological and neurological limits of individuals to receive, store, process and transmit data. Organizational theorists have long recognized data processing as a fundamental problem. Williamson (1979: note 4) stated: "But for the limited ability of human agents to receive, store, retrieve, and process data, interesting economic

problems vanish". "The problem of organization is precisely one of decomposing the enterprise in efficient informational processing" (Williamson 1985: 283).

Quantifying the ability of humans to receive, store, process and transmit data was only achieved at the turn of the last century. The then head of the British Telecom Research Laboratories Peter Cochrane (2000) quantified the physiological limits of individuals to receive and transmit data in terms of bytes as is set in Figure 1. MIT based voice recognition scientist Ray Kurzweil (1999: 103) reported the limitations of the human brain to sequentially process data in terms of bytes as noted in the centre of Figure 1. He explains how humans overwhelmingly solve problems by pattern recognition. Kurzweil (1999: 79) points out that when ten-year old girl goes to catch a ball "it follows a path that can be predicted from the ball's initial trajectory, spin, and speed, as well as wind conditions." Calculation of where to go to catch the ball "would appear to require the solution of an overwhelming set of complex simultaneous equations." These equations need to be constantly recomputed as a new visual data streams in". The point is that humans achieve complex tasks through pattern recognition developed through trial and error until the skill becomes innate not requiring conscious data processing. Driving a car is an example. Pattern recognition skills provide a rationale for business schools to educate through the case method so as to provide synthetic experiences.

The human brain is a massively parallel computer processing many bits of data at once rather than one bit at time as undertaken by personal computers at the time Kurzweil was writing in 1999. As a result, the personal computer at that time could only "emulate about a million neuron connection calculations per second, which is more than a billion times slower than the human brain" (Kurzweil 1999: 79). Like catching a ball, humans recognized faces and voices by data pattern recognition. This is why voice recognition has taken time for computers to catch up to the capabilities of the human brain.

It has now become common for all the data provided to board members to be in digital form. This allows the quantity of data received by each board member to be quantified. The time involved for its input can also be measured to identify data overload. With the use of content analysis estimates of information over load can also be obtained. Technology now makes it possible to use data measured in bits and bytes to become a unit of organizational analysis. Both Williamson (1990: xi) and Simon (1984: 40) saw the need "for observing the phenomena at a higher level of resolution". Bytes provide an answer in this regard and also answer the question raised by Williamson (1990: xi) "how micro is micro?"

<table>
<tr><td rowspan="3">Capacity in bytes/sec[a]</td><td colspan="5">Human input data channels[a]</td><td rowspan="3">Constraints in humans to transact bytes created by:</td></tr>
<tr><td>Smell</td><td>Taste</td><td>Touch</td><td>Sound</td><td>Sight</td></tr>
<tr><td><10K[b]</td><td><15K[b]</td><td><15K[b]</td><td>100K[b]</td><td>1,000M[b]</td></tr>
<tr><td rowspan="5">Nature of transacting bytes in humans</td><td>1</td><td colspan="4">Reception through organs</td><td>Physiology</td></tr>
<tr><td>2</td><td colspan="4">Storage through nervous system</td><td>Physiology</td></tr>
<tr><td>3</td><td colspan="4">Perception/understanding through the activation and strengthening of neural networks which correlate current patterns with previous ones</td><td>Physiology plus experience, training and motivation</td></tr>
<tr><td>4</td><td colspan="4">Insight/knowledge through sequential processing in neo-cortex limited to around 200 calculations per/sec (Kurzweil 1999: 103)</td><td>As above plus size and architecture of neo-cortex and psychological status</td></tr>
<tr><td>5</td><td colspan="4">External responses transmitted by movement and vocal chords</td><td>Proximity/distance, environmental conditions, culture, literacy & numeracy</td></tr>
<tr><td rowspan="3">Capacity in bytes/sec[a]</td><td colspan="5">Human output data channels[a]</td><td rowspan="3">Data received 10,000 faster than the rate at which it can be transmitted</td></tr>
<tr><td>Touch</td><td>Signs</td><td>Writing</td><td>Sound</td><td>Speech</td></tr>
<tr><td><15K</td><td><15K</td><td><15K</td><td><100K</td><td><100K</td></tr>
</table>

[a]Sources of channel capacity; Cochrane (1997, 2000; [b]K= Kilobytes, M=Megabytes

Figure 1, Human constraints in transacting bytes

A methodology developed by Turnbull (2001b) described as “Transaction Byte Analysis” (TBA) provides a way to investigate, design, and compare organizations with either hierarchical or network architecture on a quantitative basis. TBA overcomes the problems identified Radner (1992: 1384) who stated: “I know no theoretical research to date that compares the relative efficiency of hierarchical and non-hierarchical organizations within a common model” and of Demb & Neubauer (1992) who wanted a way to “compare systems of corporate governance within and between cultures”. More generally, Demsetz (1991: 159) states: "a more complete theory of the firm must give greater weight to information cost than is given either in Coase’s theory or in theories based on shirking and opportunism which have not gone far enough". Jensen (1993: 873), an author of agency theory widely used in corporate governance analysis observed: "we're facing the problem of developing a viable theory of organizations". While the emergence of network firms led Zingales (2000) to state in regards to existing theories of the firm that: “they seem to be quite ineffective in helping us cope with the new type of firms that are emerging”.

TBA subsumes Transaction Cost Economics (TCE) developed by Williamson (1975; 1985) when costs become a proxy for data and its higher order social constructs of information, knowledge, and wisdom. Information represents data that provide meaning to an observer. Meaning from non-mathematical languages cannot be quantified. Nor can knowledge that represents information that can be useful for analysis or action. Likewise wisdom cannot be quantified as it represents the knowledge of when to use knowledge. However, no change in the state of information, knowledge or wisdom can occur without the transaction of bytes.

The sharing of information is dependent on patterns of data being interpreted in a similar manner by senders and receivers. To interpret data in an identical way, the neurological circuits of individuals (or creatures) sending data needs to be closely aligned with neurological circuits of the individual receiving the data. However, the neurological architecture of even identical twins can vary according to how different external stimuli affect their brain development. "The number of neurons in the human brain is estimated at approximately 100 billion, with an average of 1,000 connections per neuron, for a total of 100 trillion connections" (Kurzweil 1999: 119). Such large numbers means that no two or more individuals can be expected to have identical neurological architecture for interpreting an identical meaning from a given pattern of data. However, cultural homogeneity with training and conditioning can commonly achieve useful approximations of shared meaning.

Notwithstanding these observations, the word "information" is commonly used ambiguously to mean either meaningful data or just data. This ambiguity will be accepted as it is in everyday usage to allow quotations that use the word "information" to be accepted without qualification. Examples are Williamson (1985: 283) cited above and for Kurzwiel (1999: 120) where he states: "The brain relies on a large degree of redundancy and a relative low density of information storage to gain reliability and to continue functioning effectively despite a high rate of neuron loss as we age".

2.1 Architecture of nature

The transaction of bytes involves perturbations in matter and/or energy. Minimizing the transaction of bytes is required to minimize the energy and/or matter creatures require to receive, store and process data required to sustain their existence as well as to avoid exceeding their physiological and neurological limits in transacting bytes. Minimizing the transaction of bytes in firms would minimize costs to allow TBA to subsume TCE.

Over billions of years creatures have evolved sustainable systems of self-regulation and governance based on survival of the fittest. Survival provides a basic criterion for achieving self-regulation and self-governance. However, competition for survival means that this needs to be achieved in the most economic, efficient and resilient manner. This in turn requires the most efficient and reliable system for obtaining signals from the environment, comparing them with past signals, processing the data and activating responses to allow creatures to sustain their existence from unknowable complex threats and opportunities.

Nature creates complexity and controls complexity by decomposing it into what Simon (1962) described as "sub-assemblies" (1962: 472) or "stable intermediate forms" (1962: 473) to create "*nearly decomposable* systems, in which the interactions among the sub-systems are weak, but not negligible" (1962: 474). These "sub-assembles", "forms" and "sub-systems" were described by (Koestler 1967) as "holons". Koestler describes a hierarchy of holons as a "holarchy" to distinguish it from a hierarchy where there is a direct "boss" (Simon 1962: 468) in a command and control system. Other terms are used to describe holons like "modules" or "capsules" (Baldwin & Clark 2006), "viable systems" (Beer 1985), "chaords" (Hock 1999), "wholes", "systems", "org", "entities" or "cooperative heterarchy" noted by Mathews (1996).

An inherent characteristic of holons is that they contain contrary characteristics such as centralization/decentralization of control, bottom-up/top-down processes, autonomous/integrated behavior and order/ambiguity (Mathews 1996: 52-53). The ability of organizations to possess contrary characteristics was noted by Dee Hock the founding CEO of the credit card company VISA international. To describe the organization he designed with these characteristics he coined the word "chaord" by combining the contrary words "chaos" and "order" (Hock 1999). The combination of contrary characteristics in physical structures allows new properties to emerge with tensional integrity or what Buckminster Fuller (1961) described as "tensegrity".

Fuller created geodesic domes by combing contrary materials like wire that has strength in tension and struts that have strength in compression. The combination of these contrary materials allows the greatest area to be covered by a structure with the least weight. The rich variety of stable or dynamic configurations that a human body can obtain arise from combining bones that work best in compression with muscles that work best in tension. Tensegrity is a fundamental feature of the "architecture of life" as described by Ingber (1998) who reports that human cells are constructed from material with contrary properties. The reason is because like geodesic domes it provides "a maximum amount strength for a given amount of building material" (Ingber 1998: 32). Tensegrity

has been adopted by evolution as the most efficient and resilient way to create and sustain living things.

DNA programs social creatures, including humans, to possess contrary characteristics like being competitive/cooperative, suspicious/trusting, selfish/altruistic and so on. I described this behavior as "Social Tensegrity" (Turnbull 2001b: 84). Social tensegrity introduces organizational integrity without the need for individual integrity advocated by Jensen (2009). TBA reveals the competitive advantages of social tensegrity. It provides creatures with a requisite variety of responses to discover those responses that will sustain their life in complex unknowable dynamic environments. Social tensegrity provides "a requisite number of responses to manage uncertainty while using minimum energy and/or materials to transact bytes (Turnbull 2001b: 134).

To paraphrase Ingber (1998: 32), it appears that organizations with holonic architecture are able to provide "a maximum amount of control (strength) for a given amount of bytes (building material)". In other words social tensegrity in organizations maximizes their ability to self-control/self-regulate/self-govern with the minimum transaction of bytes. This in turns explains how network governance can provide competitive advantages and resiliency compared with hierarchies that create information overload, and lack a requisite variety of communication and control channels to control/regulate complexity. The operating and/or competitive advantage of network organizations increases as activities increase in complexity (Craven, Piercy & Shipp, 1996; Jones, Hesterly & Borgatti, 1997).

Hierarchies depend upon obedience and conformity. In this way hierarchies inhibit the ability of individuals to act in a contrary manner as encouraged by their DNA. This problem was identified by Hock (1995: 4) in the last century who stated that:

> Industrial Age, hierarchical command and control pyramids of power, whether political, social, educational or commercial, were aberrations of the Industrial Age, antithetical to the human spirit, destructive of the biosphere and structurally contrary to the whole history and methods of biological evolution. They were not only archaic and increasingly irrelevant; there were a public menace.

Hock (1999: 6) observed before the financial crises over the last decade that:

> We are experiencing a global epidemic of institutional failure that knows no bounds. We must seriously question the concepts underlying the current structures of organization

> and whether they are suitable to the management of accelerating societal and environmental problems – and, even beyond that, we must seriously consider whether they are the primary source of those problems.

The institutional problem of individuals being inhibited to be contrary is that there is little inbuilt ability for hierarchical organizations to generate sufficient variety of responses to manage complexity. This problem is overcome with holonic organizations that possess contrary behavior. The importance of being able to generate a rich variety of responses to manage complexity arises from the cybernetic law of requisite variety that states: "only variety can destroy variety" (Asbhy 1956: 207). In regards to the law of requisite variety Ashby (1956: 245) explained that: "Its importance is that if R[egulator] is fixed in its channel capacity, the law places an absolute limit to the amount of regulation (or control) that can be achieved by R[egulator], no matter how R[egulator] is re-arrange internally, or how great the opportunity in T [system]."

The variety of responses from any regulator/controller must be sufficient to handle the complexity of the variables involved. This is why complex firms cannot be reliably centrally controlled because they lack a requisite variety of independently acting controllers. Likewise, it becomes impossible for government regulators to reliably control complex firms on a centralized top-down basis.

The purpose of government regulators is to protect and further the interests of stakeholders and society who can be harmed by a firm or put at risk by a firm. To achieve their objective regulators require a requisite variety of controllers. It is the stakeholders who regulators have been created to protect that can provide the requisite variety of control. This is why stakeholder engagement becomes an essential requirement for either firms or their regulators to reliably control complex activities as illustrated in Section 4. It is stakeholders who can expeditiously and sensitively provide the bottom-up feedback correction to protect and further their interests and that of society.

These insights explain why so called governance best practices and government regulators cannot reliably protect stakeholders. Efficient, economic and effective control and regulation of complex firms requires stakeholders to be constructively engaged in the governance architecture. This explains the necessity for introducing network governance and network regulation when complex firms are involved. The engagement of stakeholders into the governance and regulatory architecture provide a basis to further the self-regulation and self-governance of firms. The conditions for achieving self-control/regulation/governance are set out in Turnbull (2001b: 118).

Adoption of network governance would change the role of government. It would reduce: (a) the need for regulators; (b) the size and costs of government while (c) enriching democracy at the grass roots level to sustain society and the environment. The role of government would become indirect, a condition required by the law of requisite variety to amplify regulation by supplementation (Ashby 1956: 270). In the words of US Vice President Al Gore the role of government would be "to imprint the DNA" (Gore 1996) of institutions so they could become self-governing.

DNA in social creatures only survives if it programs its host to possess contrary behavior with manifold ying/yang characteristics such as approach/avoidance, etc. Contrary behavior introduces a "requisite variety" (Ashby 1956: 206) of responses that introduces checks and balances to permit the selection of the most appropriate reactions in uncertain, dynamic complex life threatening environments. While small-brained insects can survive in such environments, the 2008 financial crisis revealed that large brained highly intelligent so-called "masters of the universe" could not. The problem is that most large corporations are governed through top down command and control hierarchies that resists contrary views, bottom up initiatives or checks and balances. The inherent problems of centralized top-down governance are next considered.

3. FAILURE OF TOP-DOWN ONLY GOVERNANCE

The failure of current laws, regulations and regulators to protect stakeholders arises because each relies on a top down approach. The evidence of nature and so the science of governance reveals that a bottom up approach is also essential to reliably regulate complex organizations operating in unknowable, dynamic environments. Lawmakers and their regulators cannot control firms if firm directors and/or executives in turn rely only on a top down control system without independent feedback signals from everywhere else.

Network governance introduces bottom up control and communications from the very people governments and regulators are trying to protect. As illustrated by the John Lewis Partnership, the Mondragón Corporacion Cooperativa (MCC) and by Figure 4, it is plain common sense for stakeholders to be included in the governance architecture of firms. Michael Porter (1992) recommended this approach in his report to the US government on competiveness. But his ideas were not adopted because stakeholders on a US unitary board would introduce conflicts of interest.

What Porter did not take into account is that bottom up feedback communication in Japanese and German firms are channeled through a different board. Such boards not only obtain, (i) the information to act but also; (ii) the incentive; (iii) power and (iv), capability to act. These four

conditions are not typically present in US/UK type of disconnected capitalism as shown by Turnbull & Pirson (2012). It is by making such connections that network governance can reduce risks and provide competitive advantages.

Network governance also separates conflicts of interest and introduces different viewpoints to create checks and balances to establish more mutually effective and resilient operations. In addition, by separating the governance and management powers of directors, governance and management functions can then paradoxically be integrated throughout the firm. How this is achieved in practice by the Mondragón stakeholder controlled cooperatives is illustrated in Figure 7.3 in Turnbull (2001b: 245). Kay (1996) and Givens (1991) describe how stakeholder engagements can be added to traditional hierarchical firms.

The integration of management and governance in turn introduces self-regulation and self-governance as found in nature. Network governance provides a way to overcome the built in problems with current ideas of “best” practices for a unitary board to provide systemic solutions as indicated in Table 1. Details of “The corrupting powers of a unitary board” are presented in Turnbull (2001b: 115).

Network governance empowers Governors who take of the roles of NEDs, with information independently of management to monitor management. Without network governance, common sense suggests that the more a director is considered to be independent then the more the director lacks authority and knowledge to monitor and evaluate management and the business operations. This explains why there is no compelling empirical evidence that NEDs can improve performance or prevent disasters. On the contrary, Bhaghat & Black (2002) found evidence that increasing the number of NEDs on a board reduces performance.

The proliferation of governance codes arise because corporate lobbyists argue that to remain competitive firms need governments to adopt a “light touch” to allow self-regulation. But belief in self-regulation is irresponsible and dangerous with firms governed by a unitary board that allows directors absolute power to identify and manage their conflicts of interest (Jackson 2007). Self-regulation only becomes possible firstly if a division of powers is created and secondly if stakeholders become empowered to assists in protecting themselves. As noted above stakeholder engagement also provides a way to increase competitiveness. So self-regulation and competitiveness can be achieved together. In addition network governance provides a way to make firms directly accountable to stakeholders for their social and environmental concerns.

Table 1 How ecological governance overcomes problems of a unitary board

Systemic problems for unitary board Non-Executive Directors (NEDs):		Systemic solutions from introducing network governance used by nature described as "ecological governance":
1	Suspicion by outsiders that the absolute power of directors to identify and manage their own conflicts of interest might corrupt the directors and/or the business.	Corporate charter establishes a governance board and a management board of directors elected by cumulative voting with one vote per share and Governors with one vote per shareholder. Governors control auditors, director nomination and pay with veto powers when conflicts exist for directors (Dallas 1977).
2	No creditable systematic process for NEDs to determine when their trust in management might be misplaced.	Corporate charters makes provision for any class of stakeholders to elect a representative board to meet with governors independently of management or directors to provide feedback and/or feed forward competitive intelligence to them and/or mgrs.
3	Exposure of NEDs to personal liabilities and loss of reputation from management misdeeds.	Misdeeds of executives are the responsibility of the directors' as Governors do not have power to manage business operations. As indicated in Figures 3 & 4 directors could include non-executives.
4	No systemic access for NEDs to information opposing management views and so for evaluating management independently of managers.	Feedback from establishment of one or more "Employee Assemblies", "Creditors Councils" and "Debtors Forums" who may appoint a "Stakeholder Congress" to advise on KPIs used to determine executive appointments and their remuneration.
5	No diversity of information sources to cross check integrity of management information or obtain second or more opinions.	Diversified feedback provided from specialized stakeholders groups and their Boards with informal access to Government regulator who chairs their Stakeholder Congress. Congress chairs AGM determining pay and election of Directors and Governors.
6	Coping with data and information overload.	Compliance information and liabilities transferred to directors with option of strategic analysis transferred to a supervisory board as found in Europe.
7	Difficulties in detecting biases, errors and omissions in reports from managers.	Access to a requisite variety of independent crosschecking sources of stakeholder feedback to obtain accuracy as much as desired as demonstrated by Shannon (1948).
8	Inadequate knowledge for complex decision-making.	Simplification of decision making by decentralization into to a requisite variety of centers as described by Von Neumann (1947).
9	Board decision-making subject biases in its membership –	Exposed to multiple diverse and contrary viewpoints raised by stakeholders to force consideration of taboo topics and avoid

	Gender biases, etc.	culture of don't ask don't tell.
10	Lack of will to act against management.	Governors not captive to management information and/or executive powers and influence with independent power and/or influence on director nomination, pay and tenure.
11	Lack of a systemic way to safely blow the whistle on errors, misdeeds, etc.	Provided privately by network of boards connected to the government regulator and/or firm specific employee ombudsperson.
12	Impossibility of *directly* controlling/countering complex variables/risks.	Control amplified *indirectly* through requisite variety of stakeholders acting as co-regulators (Ashby 1956: 265).

The fact that direct amplification of reliable control or regulation is impossible has profound and widespread implications for the structure of complex organizations in the public, private and/or non-profit sectors. It means that all complex organizations need to include stakeholders as co-regulators to supplement the variety of control to improve their regulation. It also reveals the futility of top down proposals to improve corporate governance and business regulation. Some legal scholars have recognized the need for a division of board powers (Braithwaite 1997, Dallas 1997) and the need for "networked regulation" (Tomasic & Akinbami 2011) as is next considered.

4. NETWORK GOVERNANCE

Network governance can be introduced by changing corporate constitutions (Turnbull 2000a). A basic requirement is the introduction of a division of powers. This allows checks and balances to exist as found in nature, our bodies and in our brains. My PhD research revealed how the architecture of the MCC and the constitutions of its member firms exemplify "the architecture of life" (Ingber 1998). An architecture that is ubiquitous throughout the universe (Turnbull 2001b: 130, 221).

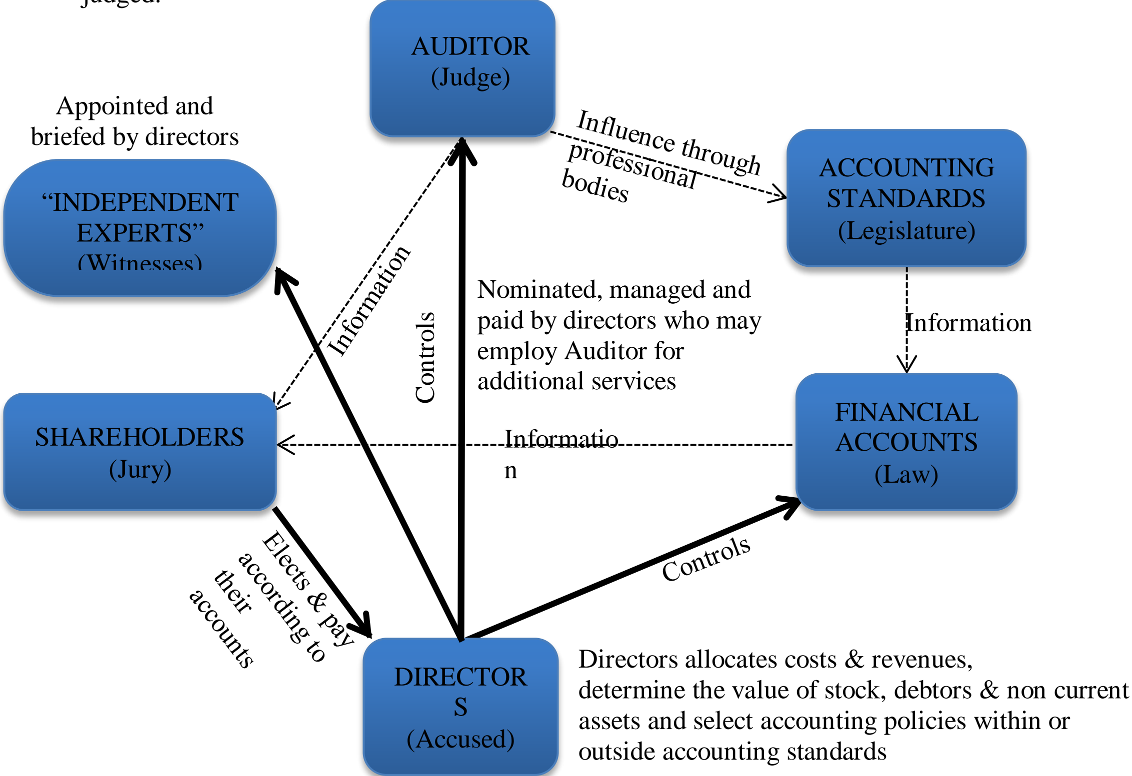
However, before reaching my PhD research epiphany, it seemed like just plain common sense to introduce elements of network governance into the constitutions of start-up-firms that I founded. I had two motives: (1) to raise millions of dollars at the lowest cost, and (2) protect my reputation as a serial entrepreneur in the event the business did not exceed. Both objectives were achieved (Turnbull 2000a, 2002c).

I introduced three basic changes. First, removing the absolute power of directors to identify and manage their own conflicts of interests to avoid the possibility of corrupting themselves and/or the business. Second, removing unethical conflicts of interest that arise for: (a) directors when they

appoint and pay the auditor who judges them, and (b) auditors when they are selected and paid by the directors whose accounts they judge as shown in Figure 2.

Fig. 2 Unethical conflicts of unitary board

In a law court it is unethical for a Judge to be paid and controlled by those being judged.



Judges in a law court cannot claim to be independent when they are selected and paid by the people they are judging. If the judge then attested that he/she was "independent", as auditors do, then it would be the judge that would be sent to jail. The third change was to remove the power of any director to chair a meeting of shareholders where shareholders were holding directors to account, determining their pay and/or their appointment. Instead, the chairman of a *shareholders'* audit committee described as a "Governance Board" chaired the AGM. Refer to Figure 3.

The separation of powers that I introduced were similar to those typically introduced by venture capitalists and bankers for providing finance. These first steps in introducing network governance do not represent a radical precedent nor would they inhibit the ability of businesses to add value and grow. Network governance protects the reputations of directors by removing suspicion and questions from stakeholders and the media that directors could be feathering their own nests rather than creating nest eggs for others. Refer to row 1, Table 1

Fig. 3 Network governance – separation of powers is the the first step to be ethical and competitive

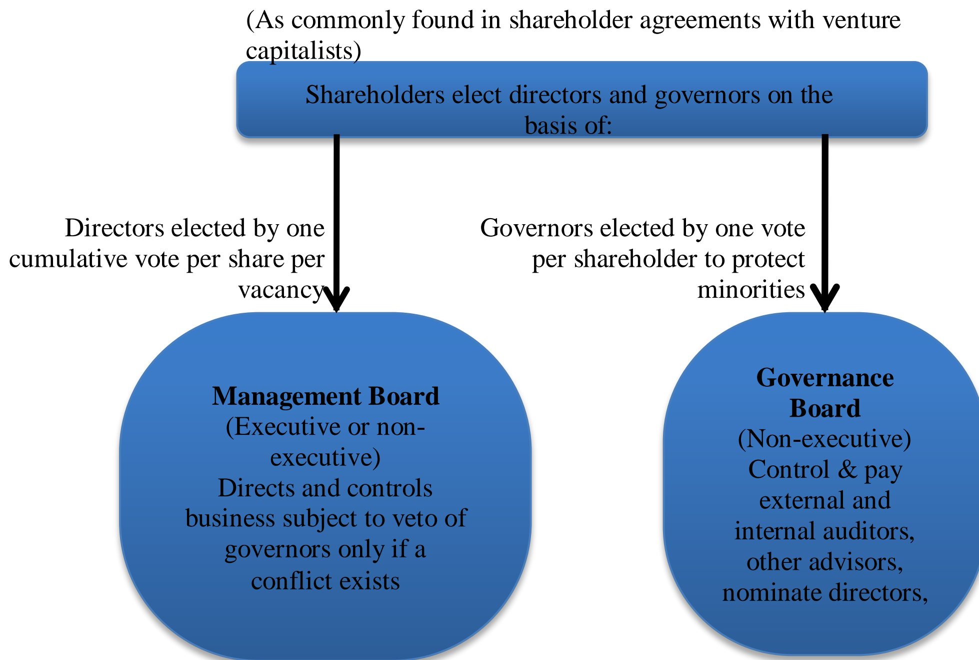
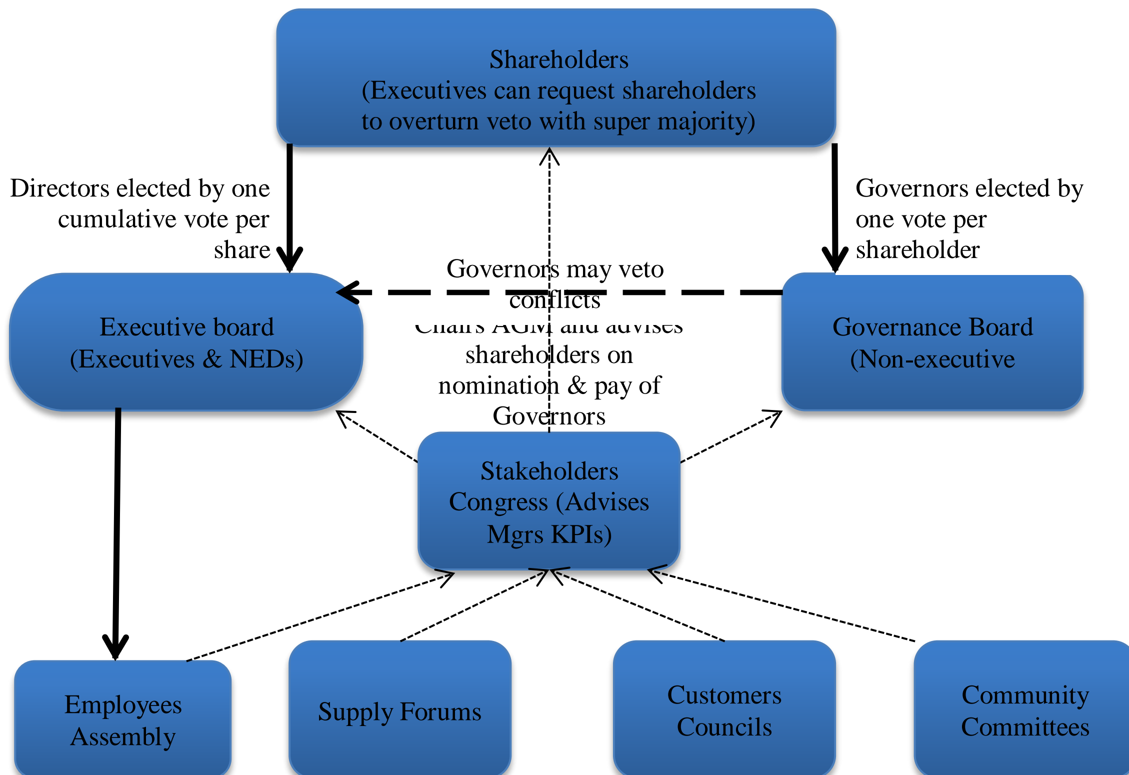


Fig. 4 Network governance – bottom up added to top down

Non-executive directors and governor not conflicted and obtain intelligence independently of managers to direct and control operations.



5. UNDERSTANDING THE ADVANTAGES OF NETWORK GOVERNANCE

Company directors, scholars and governance experts typically reject the idea of network governance when they note the complexity of networked governed firms such as presented in Turnbull (2001b: 207). While it may be counter intuitive, the tasks of individuals can be simplified by greater organization complexity as illustrated by the MCC (Turnbull 2001b: 245). Simplification in hierarchies is achieved through limiting the span of control and by introducing multidivisional forms of organizations (Williamson 1975: 32).

The eye glazing, mind-numbing complexity of the MCC control and communication architecture presented in Turnbull (2001b: 207) represents what is described as "state description" (Simon, 1962; 479; De Vany, 1998). Like the complexity of nature it can be explicated simply from a "process description" that describes how complexity is constructed from simpler components as presented in Turnbull (2001b: 221)[1]. As noted by Simon (1962: 479) "The problem of finding relatively simple descriptions for complex systems is of interest not only for an understanding of human knowledge of the world but also for an explanation of how a complex system can reproduce itself."

Centralized governance through hierarchies are now well past their "use by date" for large complex financial institutions. Pirson & Turnbull (2011) explain how firms judged too big to fail are likely also to be too big to be reliably managed, governed or regulated without network governance. In our follow up article we raise the question "Could the 2008 US financial crisis have been avoided with network governance?" (Turnbull & Pirson, 2012).

Some of the benefits of network governance for NEDs who become "Governors" are next considered. The advantages for auditors, managers, investors, stakeholder and regulators are also outlined in the following subsections.

5.1 Governors

Nine of the benefits for NEDs being elected separately by shareholders to become Governors are outlined below:

1) Role simplified and information overload reduced by the decomposition of decision-making labor that also minimizes compliance responsibilities and so personal liabilities (Clarke 2006; Page 2009; Rodriques 2007; Turnbull 2001b: 245).

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[1] The complexity of the MCC is parsimoniously summed up in the four columns and five rows of "Table 6.1, Holon typology of Mondragón" on page 221 of Turnbull (2001b). Table 6.1 allow the complexity of the MCC to be revealed as a consistent continuum of how the complexity of life is created and the universe emerges as shown in "Table 3.8, Holarchy: Hierarchy of Holons" on page 130. Table 6.1 also illustrates the point made by Simon (1962: 479): "the task of science is to make use of the world's redundancy to describe that world simply."

2) Monitoring and supervisory roles legitimatized by obtaining access rich variety information to evaluate management and the business independently of management (Shannon 1948).
3) Ability to cross check management reports for errors, biases, distortions, omissions and “spin” from additional independent communication channels from a diversity of stakeholders (Shannon 1948, Turnbull 2001b: 99).
4) Formal and informal access to industry, product and competitive intelligence and/or whistle blowers from systematized stakeholder engagement (Porter 1992; Turnbull 1997; 2000b, 2001a).
5) Creditable processes established on an independent systemic basis for learning when trust in management might be misplaced (Page 2009).
6) Exposure to most financial liabilities transferred to full time executives as NED not responsible for management decisions.
7) Unethical conflicts with financial auditor eliminated with exclusive control of internal auditor (Turnbull 2002c, 2008a, 2009).
8) Residual personal conflicts on NEDs own pay and tenure taken over or mediated by stakeholder congress.
9) Intelligence on Key Performance Indicators (KPIs) for executives provided by stakeholders exposed to services, costs and/or risks from management (Turnbull, 2002b, 2009).
10)

5.2 Auditors

External auditors obtain substantial benefits from enhancing their integrity, professionalism and role in four ways.

1) Unethical conflicts removed by Auditor no longer selected, appointed and remunerated directors whose accounts they are judging (Gitins 2002; Hatherly 1995; Haywood 2003; O’Connor 2004; Shapiro, 2004; Turnbull 2008a).
2) Unconscious bias in judging accounts is removed as identified by Bazerman, Loewenstein & Moore (2002).
3) The possibility of the auditor not being seen as being independent of the officers whose accounts they are judging is removed to remove the need for audit partner or audit firm rotation (Bazerman, Morgan & Lowenstein1997, Shapiro 2004, and Haywood 2003).
4) Access is obtained to a rich variety of alternative communication channels to cross check the integrity of corporate data independently of management (Shannon 1948).
5)

5.3 Management

Management obtains formal systemic processes for accessing stakeholder resources for enhancing operations.

1) Formal relationships established to facilitate and/or arbitrate Total Quality Management (TQM) and Just in time (JIT) processes with relevant stakeholders (Turnbull 1997; 2000a,b; 2001a).
2) Process for accessing innovational, operational and competitive intelligence from stakeholders that might not otherwise be provided on a systematic basis (Hippel 1986).
3) Facilitate stakeholder loyalty and engagement to constructively support the firm (Givens 1991).
4) Systematic process to quickly learn about problems and take corrective actions before governors/regulators.
5) Harness pro-bono stakeholder resources for continuous improvements (Givens 1991; Turnbull 1997; 2000a,b; 2001a).
6) Compliance processes integrated into management.
7)

5.4 Stakeholders

Those parties who are affected by the firm and described as stakeholders obtain formal direct and contingently influential relationships to protect and further their interests as outlined below and discussed in greater details by Givens (1991), Kay (1996), and Turnbull (1997, 2000a,b, 2001a).

1) Formal access to contribute continuous improvement programs for mutual benefits.
2) Direct access to correct poor quality goods/services and relationships.
3) Direct, quicker and more responsive access to protect and further their own interest than regulators, courts and/or public protests.
4) Strengthen constructive working relationships and mediate others.
5)

5.5 Regulators

The role of regulators is enhanced while their size and cost can be reduced in four ways as outlined below:

1) Amplification of regulation through stakeholder supplementation as co-regulators (Ashby 1956: 265);
2) Higher integrity of monitoring communications through multiple stakeholder feedback (Shannon 1948);
3) Improved formal and informal access to monitor firms and the integrity of the self-regulating processes of firms (Turnbull 2001b: 118);
4) Role changes to promoting and supervising the integrity of firm self-governance (Gore 1996).

6. CLOSING REMARKS

Even without applying the insights of cybernetics this paper reveals that the current dominant form of US/UK governance architecture and practices are not supported by common sense, ethics, theory or compelling empirical evidence. The new types of nonhierarchical firms that concerned Zingales (2000) include those with network governance. These diminish the relevancy of agency theory (Jensen & Meckling 1976) and stewardship theory (Davis, Schoorman and Donaldson 1997) commonly used by governance scholars. The diminishing arises because the role of agents and stewards can become irrelevant and/or interchanged in a network at different times.

The impotency and/or irrelevancy of governance laws, regulations, regulators and codes is demonstrated by the many recent high profile and unexpected failures. For example there are manifold and continually changing definitions of director “independence” and confusion over the purpose of seeking independence (Clarke 2006; Page 2009). Rodrigues (2007) has noted the “fetishization of Independence” not withstanding that extensive empirical survey by Bhagat & Black (2002) that found no correlation of director independence and performance with US boards. The evidence suggested that firm performance decreases as the independent directors on a board are increased. This supports the common sense observation considered earlier.

Likewise there has been a long historical confusion over the different legal purposes of external auditing in the UK and the US that has led to confusion about the role and structure of audit of committees (Turnbull 2008a). There is denial by practitioners in recognizing the unethical relationship between auditors and directors as raised by a number of scholars such as: Bazerman, Morgan & Lowenstein (1997); Bazerman, Loewenstein & Moore (2002); Haywood (2003); O’Connor (2004); Shapiro (2004); Romano (2004). Hatherly (1995) proposed that a shareholder committee should control the auditor as indicated in Figures 3 and 4 as is the practice in some European countries like France (Analytica 1992: 107), Hungary (Lempert 2003), Italy (Melis 2004) and Russia (Gitins 2002).

Regulators seem to be captive to practitioners and so limit their consideration of changes to mainly those that are only cosmetic in nature. They then falsely claim that such changes increase audit independence when the inherent unethical conflicts of interest still remain. Changes like limiting non-audit services, rotating partners and/or rotating auditors do not remove the unethical relationships. The ability of auditors to legally attest that they are “independent” illustrates how this word has become perverted from its widely accepted meaning. It is not a good look for directors and auditors to be seen by the public as not being able to recognize unethical and/or untrue relationship

by stating that in some obscure technical and largely irrelevant basis they can classify themselves as being "independent".

Likewise, fundamental changes in the concentration of corporate power and influence are little considered in new reforms (Sharpe 2010). It is time to fundamentally rethink the roles of directors, governance and regulators. The very fact that codes of behavior are required proves the inadequacy and/or irrelevancy of corporate laws, regulations and regulators. In the natural world, the control and communication system in creatures is programmed to sustain their existence on a resilient self-regulating basis without codes. Unless there is fundamental rethinking the endless revisions of laws, regulations and codes will continue to meet the political and social imperatives of being seen to being doing something to reduce unexpected failures. Governance science reveals that fundamental change is required to adopt the control and communication architecture found in nature.

Re-designing the architecture of corporate governance could be introduced on an incremental basis. In Australia I negotiated with the regulator to avoid the cost of calling an AGM to change the auditor. The exemption was granted because the regulator accepted that the democratically elected shareholder audit committee protected minority shareholders better than shareholders voting on the usual plutocratic basis of one vote per shareholder. By such processes corporations could negotiate incremental de-regulation. The UK Financial Reporting Council supported this approach by sponsoring the presentation of my paper on the 'The Theory and Practice of Government De-regulation' to a conference[2] for regulators (Turnbull 2008c).

As documented in this paper there is growing concern by legal and other scholars over the role of directors, governance and regulation in English speaking countries (Howson 2009, Sharpe 2010, Sun, Steward & Pollard 2011, Vasudev & Watson 2012). These and other scholars provide evidence of various so-called "best practices" being unethical, conflicted, counterproductive, naïve and dangerous for directors, shareholders and regulators.

There is also growing acceptance by other leading scholars of the contrary views outlined in this paper. These include my PhD examiners, editors who have solicited my contrary views in their reference books and textbooks and the many referees involved in publishing Turnbull (1995; 2000a,b; 2002a,b; 2008a,b,c; 2009; 2010; 2011; 2012). These writings provide additional details of the science and practices self-regulation and self-governance.

[2] 2nd Cambridge University Conference on 'Regulation, Inspection & Improvement, Judge Business School Centre for Business Research, 12 September 2007.

The contribution of this paper is to present both a practical and a theoretical overview for rethinking director's roles, governance and regulation. The theoretical framework provided by governance science identifies the impossibility of direct reliable control, regulation and/or governance of large complex firms with a unitary control structure by the firm or its regulator. This means that regulators are being irresponsible to allow large complex firms to exist without network governance (Jackson 2007; Pirson & Turnbull 2011; Turnbull & Pirson 2012).

As shown in section five, network governance provides numerous practical advantages for directors, auditors, management, stakeholders and regulators. The conclusion that network governance should be required for large complex firms is supported by both practical and theoretical considerations. The constructive engagement of stakeholders through network governance introduces direct democratic process for improving the social and environmental behavior of firms in way to reduce the size, intrusiveness and cost of government. It is in these ways and for these reasons that a sustainable future can be established for corporate governance practices grounded in the science of governance.

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Managerial Skills: Does Family Ownership Make a Difference?

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ABSTRACT

More than ever before, success or a failure of a modern company is the result of managers' ability to adopt his/her way of managing everyday changing circumstances. The organizational environment demands effective managers with the ability to make effective decisions which will shape business performance. So, it could be acknowledged that among several different factors that can determine a company's progress, the key factors are managers - their qualities and skills. This paper considers similarities and differences among managers in two companies in Croatia - family owned and nonfamily owned - analyzing eight essential skill areas where they should focus their efforts: understanding team dynamics, selecting and developing the right people, delegating, motivating, managing conflict, communicating, decision making and problem solving, and avoiding common managerial mistakes. Qualitative research was conducted and interesting and somewhat puzzling results were found. Results indicated that ownership made a difference concerning managerial skills. Based on the overall findings, the research offers foundation for future research in this area. The implications of the findings are discussed in terms of value for managers and their companies due to the improvement and development of all essential areas of managing.

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1. INTRODUCTION

The importance of managers' role in their work environment and the extent to which they contribute to a company's success are questions that have for long been at the center of economic debate. Mullins and Schoar (2016, p. 24) highlighted that numerous recent studies have shown that managers are key determinants of how companies are managed and of how they perform (e.g. Bertrand and Schoar 2003, Bennedsen, Neilsen, Perez-Gonzalez, and Wolfenzon, 2007, and Bandiera, Prat and Sadun, 2013). Theoretical background could be traced back to the Upper Echelon Theory (Hambrick and Mason, 1984) which suggests that a company/firm is a reflection of its managers which have a dominant influence on the firm's strategy and outcomes. By drawing upon their knowledge, experience and values, managers act based on their personalized interpretation and judgment of the strategic situations they face (Hambrick, 2007 in: Dutta, 2009, p. 9).

As Katz (1974) pointed out knowledge and abilities of managers are more important than their personality and traits. But also knowledge today is not the exclusive determinant of manager success - emphasis is on their abilities and skills that can be learned and developed. Each person who considers himself/herself as a manager, regardless of the level of management, should develop, retain, and maintain skills necessary for performing management functions (Bahtijarević-Šiber, Sikavica and Pološki-Vokić, 2008, p. 3).

The fact of how crises in companies occur even in situations when they are successfully expanding is not surprising. This often happens because managers are not capable of running them and developing them further due to lack of necessary knowledge and managerial skills (Papulová and Mokroš, 2007). Namely, today's companies operate in challenging circumstances where situational factors are changing frequently, so, more than ever before, success or a failure of a company is the result of managers' ability to adopt their way of managing to these kinds of environments. In order to have prompt and adequate responses to pressures from all sides, they must have not only the knowledge of how to do something, but also developed skills. Managers' abilities "to understand and describe the economic performance potential of a firm's endowments" (Barney, 1991, p. 117) "rests on the integration of all, or most, of the relevant managerial skills" (Carmeli and Tishler, 2006, p. 10).

Research into managerial skills is not new in the field of economics and management. This topic has long attracted the attention of many researchers. Because of the role that managers have in today's business settings, research interest into managerial skills has increased over the last decade. Among many researchers a consensus could be noticed regarding the notion that managers are a critical and vital resource for company success, because of the significant influence they have over strategic decisions, their implementation and consequently on the company's overall success on the market.

The objective of this paper is to explore similarities and differences among managers in family owned and nonfamily owned companies by analyzing eight essential skill areas where they should focus their efforts: understanding team dynamics, selecting and developing the right people, delegating, motivating, managing conflict, communicating, decision making and problem solving, and avoiding common managerial mistakes. A large number of studies have focused on the differences between a family and a nonfamily company (Mullins and Schoar, 2016, p. 25) considering the size of the company, performance, governance structure, CEO position, leadership style, decision making style, etc. But, to our knowledge, there is no study that has analyzed whether family ownership makes a difference concerning managerial skills. This study aims to undertake a comparison between a family and a nonfamily company in Croatia, hypothesizing that when considering developed managerial skills, ownership does make a difference. This research contributes to the literature on management and leadership as well as on family firms in emerging markets.

2. MANAGERIAL SKILLS

Among the several different factors that can determine a company's progress, the key factors are managers - their qualities and skills. In fulfilling their duties managers use managerial skills which can be learned and gained by training (Papulova and Mokroš, 2007, p. 1). According to Yulk (2002, pp. 175-6) the term "skill" refers to the ability to do something in an effective manner (Carmeli and Tishler, 2006, p. 13). Successful and effective managers who are capable of responding proactively to pressure which is a part of their daily business activities, in addition to conceptual knowledge, must know how to behave in a given situation and how to get feedback on the effects of their performance. So, it could be acknowledged that managers require basic skills to establish organizational goals and determine appropriate strategies to achieve these goals (Pansiri and Temtime, 2006, p. 252).

Several researchers have identified skills that effective managers should possess. For example, Katz (1974) identified three types of skills: technical, human and conceptual. His three-skill taxonomy was developed with regard to the skills' importance for successful leadership. Christensen et al. (1978) identified human sensitivity, administrative ability, persuasion, articulation skills, creative skills, intellectual ability, and conceptual ability. His typology was developed with respect to types of leadership (taskmasters, mediators, motivators, personal leaders and architect leaders). Castanias and Helfat (1991) identified generic skills, sector related skills and organization-specific skills considering hierarchy of skills. Mumford et al. (2000) proposed three types of skills: complex problem solving skills, solution construction skills and social judgments skills. Whetten and Cameron (2001) identified ten key management behavioral skills: verbal communication, managing time and stress, managing individual decisions, recognizing, defining, and solving problems, motivating and influencing, delegating, setting goals and articulating a vision, self-awareness, team building and managing conflict. These skills were related to highly effective managers. Further, Yukl (2002) proposed this typology of managerial skills: cognitive complexity, emotional and social intelligence, self-awareness, cultural sensitivity, behavioral flexibility, and the ability to learn from experience and adapt to change. Carmeli and Tishler (2006) proposed nine managerial skills of successful managers: persuasiveness, administrative ability, fluency in speaking, knowledge about group tasks, diplomacy and tact, social skills, creativity, conceptual skills, and cleverness.

Considering the fact that managerial skills are not unique in the sense of their universality, the question is which skills are important today. An effective manager is the one who should have an extensive set of developed skills in all essential areas of managing - from planning and delegation to communication and motivation. These areas of managing become, with the company's growth and progress, more complex and demand more attention. That is why managers, regardless of the type of company, must have specific knowledge and skills to be capable of successfully performing their jobs. Those managerial skills needed to be developed and upgraded over time. In this paper eight essential skill areas where managers should focus their efforts are analyzed:

Understanding team dynamics and encouraging good relationships – Managers must understand how their teams operate. They need to be aware of the diversity regarding their personality, abilities,

skills, and perspectives, and pilot those differences in a positive direction. They should provide encouragement and support in order to help the team to maximize efficiency.

Selecting and developing the right people – Managers must have good recruitment skills, because selecting and developing the right people is a basic requirement for achieving excellent results of the entire company. Nevertheless, a manager's individual success resides in his/her ability to select the right people.

Delegating effectively – Delegating the tasks to the right people and clearly outlining the expectations determine success of the managers themselves and the company overall. Delegation is one of the managerial skills worth improving. It enables managers' progression and multiplies managers' effectiveness. It has a positive effect on motivation and the individual development of employees. Consequently, it has a huge positive impact on the company.

Motivating people – Managers must have developed motivation skills if they want high performance employees who will, through high job satisfaction, interesting and challenging work tasks, achieve valuable and meaningful individual and organizational goals, and thus contribute to the overall business results.

Managing discipline and dealing with conflict - Effectively managing discipline and conflict is very hard job for the manager to do. People are diverse. They have different personalities, viewpoints, abilities which sometimes can escalate to personal and organizational disagreements and conflicts. Managers must discipline the members of the team trying to facilitate a resolution or avoid destructive conflict between employees if they want the company to progress.

Communicating – This is considered as a critical managerial skill. Effective communication skills are essential to company success since the manager must communicate to all stakeholders and since the level of communication effectiveness leads to more or less successful achievement of objectives.

Planning, making decisions and problem solving - Planning, problem solving and decision making are critically important skills for managers because these activities can make a great difference not only to individual managers' careers, but also to the company's position on the market.

Avoiding common managerial mistakes - It is in human nature to make mistakes. While making mistakes a person is learning, because mistakes can provide great learning opportunities. It is imperative to learning how to recognize and avoid common mistakes that managers make. This can help them to become more successful and productive, and consequently, their company can benefit.

3. FAMILY OWNERSHIP

Family companies have a long tradition and are dominant contributors to the wealth of the world economy. They have been the focus of numerous studies during the last decade due to their capacity to generate employment as well as their essential role in the wealth creation process (Garcia Perez de

Lemac and Durendez, 2007). Estimates put the proportion of family businesses worldwide between 70 and 90 percent (Shanker-Carey and Astrachan, 1996; Colli, 2003).

The family business is considered to be a form of business where control /ownership and management are concentrated within the members of the family (McClendon and Kadis, 2004). The friction between loved ones and business interest is what makes family businesses unique (Carlock and Ward, 2001). It has complex family and business issues to deal with in order to sustain growth. As a consequence, numerous studies have been carried out that attempt to identify and classify all manner of differences between family and nonfamily companies (Smith, 2007; Nauman Khan and Khan, 2011; Stavrou, Kassinis and Filotheou, 2006). Family businesses exist in two social systems: business and familial systems. The family system is characterized by emotional and stressed family relations and loyalty, while the business system is unemotional and contractually based.

Several researchers and observers have claimed that ownership matters and that the economic behavior of companies is influenced by how property rights are allocated and by who their owners are. But, according to Barth, Gulbrandsen and Schone (2005), the issue is not settled. In their research they compared the performance of family-owned versus nonfamily-owned companies in Norway and the results showed that family-owned companies are less productive than nonfamily-owned. That productivity gap is explained by differences in management regimes. They pointed out that family-owned companies managed by a manager from outside the owner family are equally productive as nonfamily-owned companies. However, family-owned companies managed by a person from the owner family, are found to be significantly less productive than nonfamily-owned.

The aim of another study was to test the main differences between private family business and nonfamily business in Spain with regard to management variables such as: strategy, strategic planning, manager's training and professionalism, and financial techniques implementation (Garcia Perez de Lema and Durendez, 2005). On a sample of 456 family companies and 183 nonfamily companies, the authors concluded that the strategic orientation adopted by family companies to compete in markets is similar to that followed by nonfamily companies. However, when they analyzed the way family companies make use of different competitiveness factors they have found some weaknesses that they need to correct. Family companies devote fewer resources to training, they attach less importance to education as a competitiveness factor, and they have a smaller proportion of managers with a university degree. Authors also found that family companies give less importance to the improvement of detailed and rigorous management planning in comparison with nonfamily companies.

Further, Nauman Khan and Khan (2011), researchers from Pakistan, tried to distinguish family run companies from nonfamily run companies by comparing their performances on a sample of 100 firms (50 family and 50 nonfamily) over a period of five years. Their most fundamental aim was to determine whether the type of ownership has any effect on the company value. Their results clearly reflected that nonfamily companies are better than family ones and they outperformed family companies with every performance variable that was included in research. Family companies, it

seems, are more prone to indulge in private benefit extractions at the expense of minority shareholders.

It is obvious that the curiosity surrounding the relationship between family control and ownership and company performance has attracted much research around the globe. There are also positive results relating to the family effect on company performance. For example, Mishra, Randhoy and Jensen (2001) came up with a positive analysis of family companies while doing their research in Norway, so did Barontini and Caprio (2006) who also found a positive relationship between family control and company performance in Italy(e. g. Anderson and Reeb, 2003;SraerandThesmar, 2006;Favero, Giglio, Honoratiand Panunzi, 2006). In other words, previous results and literature are mixed with both types of results: some say that family run companies perform better while others are of the opinion that the presence of family destroys the company's value.

In spite of family businesses' worldwide importance, the literature relating to family businesses issues is not proliferous, and in Croatia it is still at the emergence stage. The lack of knowledge about family businesses is also evident during the everyday contacts with entrepreneurs, owners and/or family business managers, who try to maintain family businesses in a successful way and for which management and conduction of family businesses is one of the most challenging tasks (Kružić, Pavić, Šustić, 2008). Nevertheless, results to date have been mixed and conflicting, and despite the numerous empirical studies, doubts remain as to whether family ownership and family management are good or bad for business (Miller, Minichilli and Corbetta, 2013).

To contribute to general research in comparing family and nonfamily business and to the so far limited literature that has examined this topic in Croatia, the authors of this paper, as mentioned earlier, tried to explore the similarities and differences among managers in family owned and nonfamily owned companies by analyzing the main skill areas where they need to focus their efforts and have gained some very interesting results which will be discussed in the following chapters.

4. METHODOLOGY

In an attempt to give an adequate answer to the research question and to provide the reader with an in-depth understanding of managerial skills in two different companies in a Croatia, authors decided to use the qualitative case study research method. The units of analysis were two different companies: family owned and nonfamily owned. Family owned was a Limited Liability Company, with 100% private (family) ownership. The other one was a Joint Stock Company, majority owned by two private companies. The reason for choosing these two companies in particular are the following: they both had survived the crisis period and continued to successfully operate in a turbulent and politically unstable environment. Furthermore, both companies were in the category of large enterprises (the number of employees was the main criterion used in defining large enterprises - they had about 500 employees); they were both representative of the economic activity they performed and

of their importance in the national service structure. Furthermore, both had earned an enviable reputation for their economic activities, for meeting high standards in performing various tasks, for their orientation towards international markets, for high and continuous revenues and for their contribution to increasing employment in their region.

Since the analysis was aimed at defining similarities and differences among managers in the aforementioned companies, the case study method was used. The case study method is used in cases that require profound understanding of the research subject, since its results provide the answers to the following questions: *why*? and *how*? (Yin, 2003). In contrast, the questions *what*?, *who*? and *when*? usually refer to the so-called sample method. The case study method is extremely useful in terms of challenging and redefining existing theoretical frameworks and offering scope for new hypotheses (Saunders, Lewis & Thornhill, 2003). This method is aimed at expanding the existing theoretical frameworks. In other words, the ultimate result of the method is analytical, not statistical, generalization.

Qualitative research was carried out using the in-depth interview method (interviews with the managers of the analyzed business entities). In order to carry out a thorough analysis of the business entity, a structured questionnaire was also used in the research. Preparations for the analysis of the business entity also included internal documentation analysis. The audio scripts also proved invaluable for the analysis. The aforementioned structured questionnaire was used in the course of the interviews as the research instrument.

The questionnaire was structured in two parts and it was used as the main research instrument. Its first part was focused on the basic information about the managers and the second part contained questions concerning managerial skills. The first part of the questionnaire included demographic questions of the respondents such as age, gender, education level, years of experience, position on managerial pyramid in order to see the clearer picture of managers in these companies. In the second part the questions were focused on eight essential skill areas: understanding team dynamics, selecting and developing the right people, delegating, motivating, managing conflict, communicating, decision making and problem solving, and avoiding common managerial mistakes.

Namely, after the questionnaires were gathered in order to have a clearer understanding of managerial skills, face to face interviews were done with all managers in both companies. Actually, the questions during interviews were similar to those in the questionnaire in order to get as much valid data as possible and to make some judgments, recommendations with more certainty, so as to gain a clearer and more realistic picture of managerial skills in these companies.

A total of 15 managers participated in the research. They filled out the questionnaire in the required manner and participated in interview process. They were informed about the scopes and benefits that the research will produce for them and their company. They were all very interested in the research subject and provided detailed answers to our queries. In order to perform statistical analyses, data obtained with questionnaires were collated and processed using the SPSS 23.0 and

Microsoft Excel software, accompanied by Microsoft Visio, aimed at results' presentation. In this sense, the demographic characteristics of the research sample are shown in Figure 1.

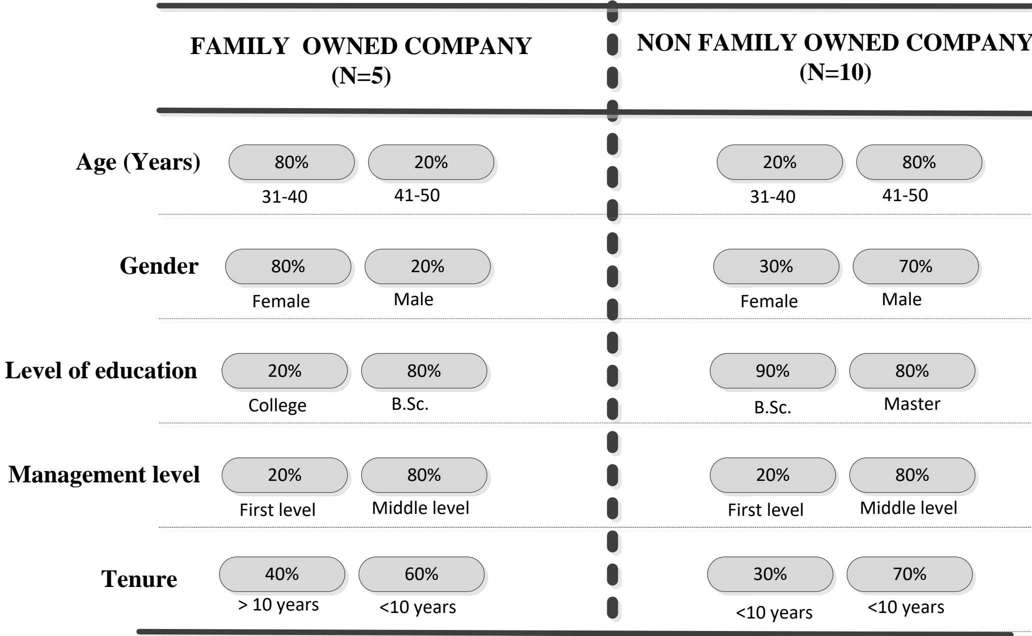


Figure 1: Demographic characteristics of the research sample

As presented in Figure 1 among three basic demographic characteristics in two analyzed companies, similarities cannot be found. Namely, family managers are younger and, surprisingly, are mainly female compared with nonfamily managers. Also, interesting but expected, nonfamily managers have a higher level of formal education. It is often the case that family members attain informal education through mentoring which substitute formal education that refers to high school and higher education degree.

5. FINDINGS

The obtained data from the questionnaires and interviews after conducting all analyses offered interesting results and insights. In the following text, only the most important results were presented. Once managers filled out the questionnaires, detailed face-to-face interviews were conducted. Table 1 and 2 present relevant findings that were obtained through interviews where we got managers' opinions about the need for each skill in their present job and through questionnaires where we obtained the real situation (managers' perceptions) of the degree to which each skill was developed. Namely, managers in both companies were asked to evaluate to what extent they possessed eight managerial skills. Statements were on a five-point scale ranging from 1= not at all, to 5= very often. Managers were asked to answer the questions from the current position to the current state, meaning

that for each statement they chose the answer that best described him/her. There were 2 – 3 questions/statements for each managerial skill category.

Table 1 considers results for family owned company, while Table 2 for nonfamily owned company. It shows that the majority of family business managers indicated that all eight skill categories were very important for business success. It showed that an effective manager required a wide range of skills, and that each of these skills complemented the others. As it can be seen from the table, the most developed skill areas were: communication, decision making, team building, and human resource development. Areas in which managers should focus their attention and work harder were: delegation and avoiding mistakes. However, if properly done, delegation successfully contributes to the increased responsibility and prevents managers from being drowned into routine activities and focused on the most critical issues. Skilled managers can tap employee strength by proper delegation of tasks (Pansiri and Temtime, 2006).

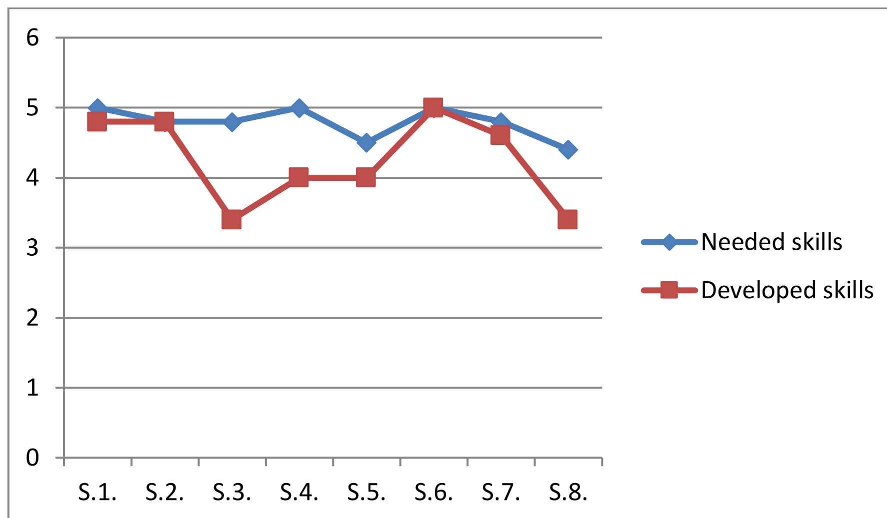
Table 1: Needed and currently developed managerial skills in family owned company

Index	Managerial Skills	Needed skills	Developed skills
S1	Understanding team dynamics and encouraging good relationships	5	4.8
S2	Selecting and developing the right people	4.8	4.8
S3	Delegating effectively	4.8	3.4
S4	Motivating people	5	4
S5	Managing discipline and dealing with conflict	4.5	4
S6	Communicating	5	5
S7	Planning, making decisions, and problem solving	4.8	4.6
S8	Avoiding common managerial mistakes	4.4	3.4

Source: Research

Line chart below (Chart 1) presents a graphical representation of data in Table 1. In this two-dimensional scatter plot of ordered observations where the observations are connected following their order, clear differences could be seen between managers' perception of the extent to which skills should be developed in their workplace and the extent to which these skills were actually developed.

Chart 1: Needed and currently developed managerial skills in family owned company



Source: Research

Considering the real situation in the company, their goal should be to develop and improve all skills on an ongoing basis as they meet new business challenges. This will lead to the efficient and effective accomplishment of the company's objectives.

In the light of the main research question, and curious about the impact of ownership, we further analyzed the responses of nonfamily business managers following the same procedure as in a family company. There were no response differences considering managers' perception about needed stage of development for each skill area. With close to approximately 100% in both companies, managers indicated that all skill areas were of great importance for overall business success. As for nonfamily managers and situation in which they were, regarding possession of each managerial skill, they were in a slightly worse position compared to the family manager. Namely, the average points show that motivation, decision making, and conflict management were the most developed skill areas, while delegation and avoiding mistakes are the less developed. It is interesting to note that these two skill areas were also the least developed in the family company. The difference was the one that in a family company these two skill areas were at the higher level of development (see Chart 3).

Table 2: Needed and currently developed managerial skills in nonfamily owned company

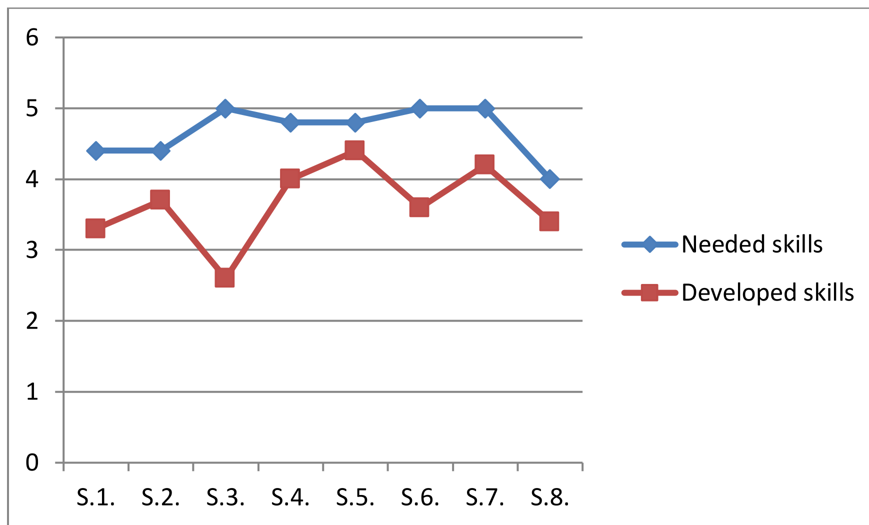
Index	Skills	Needed skills	Developed skills
S1	Understanding team dynamics and encouraging good relationships	4.4	3.3
S2	Selecting and developing the right people	4.4	3.7
S3	Delegating effectively	5	2.6
S4	Motivating people	4.8	4.0
S5	Managing discipline and dealing with conflict	4.8	4.4
S6	Communicating	5	3.6
S7	Planning, making decisions, and	5	4.2

	problem solving		
S8	Avoiding common managerial mistakes	4	2.7

Source: Research

Again, the chart below gives a clear picture of the obvious differences between managers' attitudes about needed skills and the real situation regarding its development. When it concerned the nonfamily company this difference was even greater.

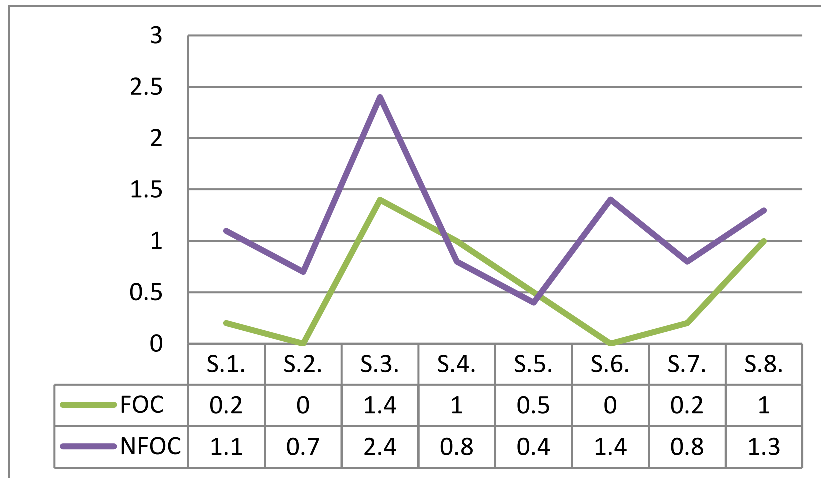
Chart 2: Needed and currently developed managerial skills in nonfamily owned company



Source: Research

An additional analysis was obtained to show the exact degree of deviation regarding the extent to which the company's managers possessed eight managerial skills. As already mentioned, a difference was found, which Chart 3 clearly shows. A graph actually reinforces what was described in previous tables: family business managers were closer to the desired state regarding the extent of development of managerial skills, when compared with nonfamily business managers. Therefore, it may be argued that there was a difference regarding managerial skills among managers in the two companies in the Croatia - family owned and nonfamily owned and that family ownership did make a difference.

Chart 3: Deviation between needed and developed managerial skills in family and nonfamily owned company



	S.1.	S.2.	S.3.	S.4.	S.5.	S.6.	S.7.	S.8.
FOC	0.2	0	1.4	1	0.5	0	0.2	1
NFOC	1.1	0.7	2.4	0.8	0.4	1.4	0.8	1.3

Source: Research

The overall picture of managerial effectiveness is presented with Figure 2.

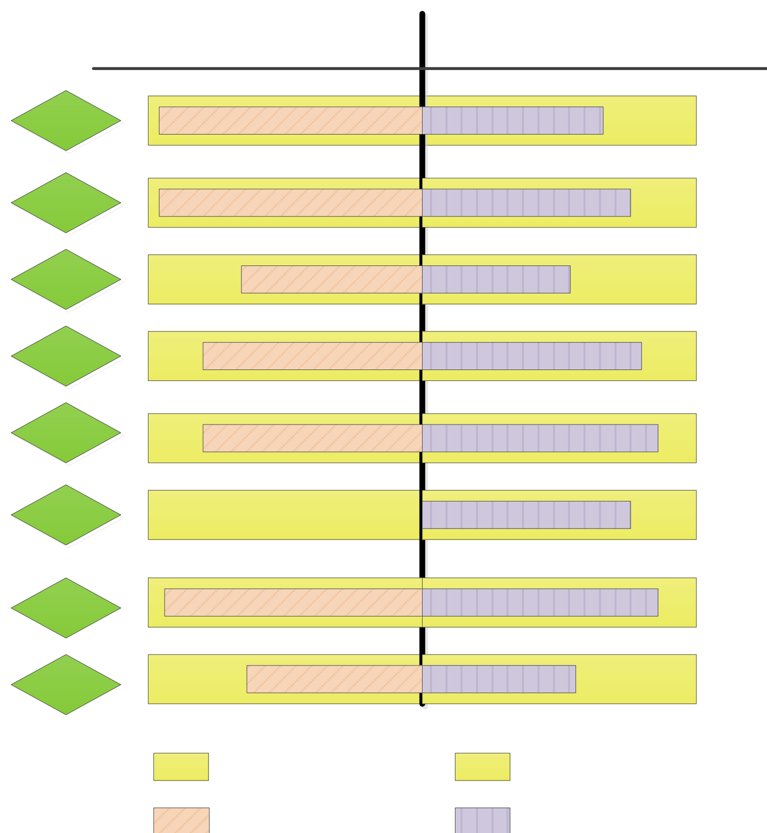


Figure 2: Managerial effectiveness - comparison of possible and actual state

It could be stated that managers in a family own company were more effective compared with managers in a nonfamily company. The values for each essential skill area were greater when a family

company was considered. In the four skill areas they reached close enough or completely the maximum value (Max=5). Perhaps, the answer to the question - why is this so – could be attributed to the fact that managers in the family company were mainly female. As can be seen from the figure, the largest minimum value was noticeable in the nonfamily company - so, it could be concluded that managers in a nonfamily company should focus more efforts on the development of their managerial skills. Those eight managerial skill areas could be some of the key skills needed. With further improvement of those skills managers can become more effective which in turn can have a major impact on individual and organizational performances. Therefore, great emphasis should be on managerial skills enhancement.

6. CONCLUSIONS

This study provided an insight into similarities and differences among managers in a family owned and a nonfamily owned company considering eight essential skill areas where they should focus their efforts: understanding team dynamics, selecting and developing the right people, delegating, motivating, managing conflict, communicating, decision making and problem solving, and avoiding common managerial mistakes. The interview results showed that the majority of managers in both companies indicated that all eight skill categories were very important for business success. They all pointed out that an effective manager requires this range of skills, and that each of these skills complements the others.

Compared with the questionnaire results of the current stage of each skill development, some interesting differences were found. Where family business managers were concerned, the most developed skill areas were: communication, decision making, team building and human resource development. Areas in which family business managers should focus their attention and work harder are: delegation and avoiding mistakes. Interestingly, the same situation was found with nonfamily managers when considering the less developed skills. The difference is that in the family company, these two skill areas are at the higher level of development.

Also, in addition, the results showed that family business managers are more close to the desired state regarding the extent of development of managerial skills, when compared with nonfamily business managers. Therefore, results suggest that there is a difference regarding managerial skills among managers between the two companies in Croatia - family owned and nonfamily owned and that family ownership does make a difference. Furthermore, findings showed that managers in the family owned company are much more effective compared with managers in the nonfamily company. The values for each essential skill area are greater when family company is considered. Since family companies differ from other type of companies because they are owned and/or controlled by families, these differences are not surprising.

Overall, it can be concluded that success or a failure of company, regardless of the ownership structure, is frequently dependent on the capabilities and competency of managers in directing a company to compete on the market. Companies need to grow and develop to survive in the current environment. This requires mastering many types of managerial skills. Different types of research revealed that for successful job performance, managers are required to possess and nurture specific knowledge, skills and abilities. As mentioned in the paper, managerial skills can be learned and gained by training. Therefore managerial skill training is an important part of managers' education.

Limitations of this study and suggestions for future research are closely linked. Indeed, future research may reduce the limitations. There is no doubt that these research results produce new questions. More research needs to be done to resolve these questions, but we have the foundations. This research can be upgraded into several directions in order to get a more detailed and complete picture about managerial skill development in Croatia in companies of any kind. Future research in this area would benefit from studies aimed at increasing the sample to achieve more easily generalization of the research conclusions. It would be beneficial to make a comparison between public and private, commercial and non-commercial, and manufacturing versus service companies. The importance of managerial skills should also be discussed in relation to the external environment, as well as the size and age of the organization.

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Contemporary issues in retail industry

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A B S T R A C T

With regard to both the consumer behavior and the overall competition structure, the retail industry is constantly changing. Each industry has its peculiarities, retail is no exception. The customer loyalty levels are decreasing, therefore, the retail management at large has to decide which effective measures to take, in order to simultaneously gain new customers and retain the existing ones. At present, the average buyer is educated, experienced, and keenly self-aware of his/her importance, as well as of the entire purchasing process. Consequently, it is essential to obtain access and keep the buyer satisfied. The changes required, with regard to the management of retail chains, should thus cover all the stages of the process, ranging from the procurement to sales. In this particular paper, we examine the corporate governance process and its' requirements of competing on the retail market. The overview of the entire organizational structure and the processes required to operate under current retail management conditions will be analyzed. The findings will prove to be quite beneficial to Croatian retail companies and aid in overcoming the major threat of EU competitors, laying out the changes necessary for survival within this particular industry branch.

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1. INTRODUCTION

The business world has reached a point at which environmental issues can no longer be ignored. Business results are nowadays achieved not just by increasing the volume overturn. Numerous new factors enter the consideration, namely, the demographic impact of the aging population, increased urbanization and digitalization levels. The present World is changing at an ever-increasing pace, with the differences between socioeconomic groups on the rise, changing daily. In such circumstances, the management is having serious difficulties when choosing the most optimal strategy. Numerous parameters have to be taken into account. The retail strategies that have previously been successful are no longer valid. Throughout history, consumption was the combined result of the population increase and the opening of the new stores. Today's consumer is a rational player, one considering numerous differing factors. Thus, this change in consumer behavior leads to a shift in business paradigm, creating the need for companies to adapt to new trends, or face extinction. In this paper, various factors impacting strategies and managerial responses will be examined, with case studies of successful companies within the retail industry. This paper will serve as a guide to the Croatian retail companies, advising them on ways feasible in responding to the modern consumers' demands.

2. Factors affecting the modern retail industry

Three main trends are affecting the retail industry [1]: urbanization, aging population and digitalization. Nowadays, companies need to seek out profitable markets and consumer segments, their geographic location and the manner in which they prefer to spend money. Today's market, represents the most diverse consumer market throughout history.

2.1. Urbanization

According to the Business dictionary definition, the urbanization is the increase of the population dwelling in cities and towns, which stands in contrast to the rural areas. The increase in urbanization began during the industrial revolution, as workers migrated to the urban manufacturing hubs, in order to obtain jobs in factories; as agricultural jobs became less common. Urbanization is a process that, historically, parallels the increase in migration, economic development, aging of the populace and a decrease in fertility. This process was influenced by both social and economic factors. Urban life contributes to higher education levels, better overall healthcare and quality of life. However, because of it not being a controllable process, it also has several side effects, namely, a faster life pace, increased pollution and traffic, especially when the effects of unplanned urbanization are considered. Also, when compared to rural existence, the urban life has larger income discrepancies and socioeconomic mobility. Although the urban lifestyle offers many advantages, numerous urban residents live in poverty. In 2007, for the first time in history, the overall global urban population exceeded the rural one. Thereafter, the World populace remained predominantly urban. Over the past six decades, the planet has gone through a process of rapid urbanization. In the 1950, 70% of people worldwide resided in rural settlements. In the 2014, 54% of the global population was urban. The projection for 2050 is that the urbanization will continue unabated, with 34% of the people being rural and 66% being urban. In essence, this will reverse the mid-twentieth century rural-urban population distribution. [2]

Table 1. Contribution to global consumption growth (%)

	1970-1985	1985-2000	2000-2015	2015-2030
Per capita consumption growth	45	47	58	75
Population growth	55	53	42	25

Source: World Bank; McKinsey Global Institute Cityscope; McKinsey Global Institute analysis, 2016

As is shown in Table 1, the consumption growth has been determined by the population growth. Nowadays, the trend is changing, as the year 2000 consumption per capita growth levels are overtaking the consumption growth. By the year 2030, the impact will be quite substantial, with the 75% per capita consumption growth [3]. Consumer growth is thus not based on solely the expanding populace. Nowadays, customers' needs, service and mind-set are paramount. Therefore, the companies need to respect the individualism of each customer. Global population growth rates are expected to decrease, however, the overall increase in consumption has to be taken into account when creating the business strategies and tactics.

By the year 2030, the consumers in large cities will account for 81% of the entire global consumption. However, they will still make about 50% of the overall populace, generating 91% of the World consumption growth during the 2015-2030 period. Global urban consumption is extraordinarily concentrated - just 32 cities are likely to generate 25% of the overall 23 trillion USD of urban consumption, with 100 cities responsible for 45% of the 2015-2030 growth rate [4].

Increased urbanization is influencing the shifting of retail companies' strategies. The market has never been more diverse, there no longer exists a standard customer in the standard market. Urbanization has led to significant differences in the financial status, cultures and behaviors of inhabitants dwelling within the same city. The services provided to the consumers have become quite important, making it perhaps even a decisive factor. All of the factors considered demonstrate the difficulty companies face when choosing the right retail strategy and the existing need for more alternatives, due to the large variability of customers.

2.2. The aging populace

According to the survey of the United Nations, "World Population Prospects: The 2015 Revision, Key Findings and Advance Table", there are 901 million people of or over 60 years of age, making up 12% of total populace. The population aged 60 or above is growing at a rate of 3.26% each year. Currently, Europe has the highest percentage of population aged 60 or over (24%). However, the rapid population ageing will occur in other parts of the World as well. In fact, by the year 2050, all the major areas of the World, excluding Africa, will have nearly 25% or more of their population aged 60 or over. The number of elderly people in the World is projected to reach 1.4 billion by the year 2030 and 2.1 billion by the year 2050, with a possibility of rising to 3.2 billion people in the year 2100. In the short-to-medium term, a higher percentage of elderly population is inevitable, with those people already amongst the living [5].

There are several World countries that are expected to decrease in population, 48 of them, during the 2015-2050 period [6]. Several countries are bound to experience a population decline by more than 15% by the year 2050, including Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Japan, Latvia, Lithuania, Republic of Moldova, Romania, Serbia, and Ukraine. The fertility rate in all the European countries is, at present, below the level required for a long-term full population replacement (around 2.1 children per woman, on average). Additionally, in the majority of cases, the fertility rate has been below the replacement level for several decades. Fertility for Europe, as a whole, is projected to increase from 1.6 children per women during the 2010-2015 period, to 1.8 during the 2045-2050, however, such an increase will not prevent a likely contraction of the total population size [7].

Both the European market and the companies are facing an aging population. Consumers aged between 60 and 75 years will thus grow more than 30%, contributing to more than a half of the urban consumption growth, during the next 15 years, for the developed markets. The retail companies, at present, do not provide them with proper attention. However, in the future, they should aim to transform the elderly into loyal customers. For every dollar spent shopping, they also spend 25% more time, when compared to the prime-age people. This is just another reason for the companies to focus on this particular, powerful demographic path. [8].

The age factor in consumption behavior provides an additional indication of the level of welfare among the elderly. In the high-income countries, the consumption of the elderly people does not plummet following retirement, as a matter of fact, they spend a third more than other groups of people. In contrast, the elderly in low or middle-income countries, unfortunately, no longer possess the sufficient income, simultaneously failing to save enough funds for medical services and other various expenses [9].

2.3. Digitalization

The digitalization process is one involving the integration of digital technologies into everyday life, by digitizing everything that can be digitized [10]. The impact of digitalization is omnipresent, with the retail industry affected as well. The digital commerce is continuing to grow, and consumers are becoming increasingly methodical in their purchasing behavior. This is shown by the fact that more and more Europeans regularly shop online, spend a higher average amount than ever before. In the survey „Online Retailing in Europe, the U.S. and Canada 2015-2016“ by the Centre for retail research, the total online sales in Europe were at 214.11 billion USD in 2014, an 18.4% increase when compared to the previous year. The online retail market share, when compared to the brick-and-mortar option has a sales-weighted average of 6.3% in 2013, growing by 7.2% in 2014 and 8.4% in 2015. In the year 2014, there were 178,882 million online shoppers in Europe, which represents 46.7% of the entire populace, infants included. The mobile online market is the fastest growing facet of the online retail, with more than 50% of the views on some sites coming from mobile devices. The mobile online retailing, comprised of both smartphones and tablets, provided an average of 12.5% (32.57 billion USD) of total online spending in 2014 [11]. The digitization process thoroughly changed the business paradigm, with the ultimate outcome still being uncertain. Applying the digitization process to a company should be accepted by all the employees and not taken easily. The employees' efforts and involvement is essential, with the

departmental integration being inevitable. Although the customers accustomed to digitalization and indeed, demand it, the human contact never ceased to be an influential factor.

3. RESPONDING TO THE TRENDS

Retail companies are observing their business environment on both daily and long-term basis. In accordance with the trends, companies change or adjust their overall sustainable strategy. Three main trends shaping the future of retail business have been determined: the urbanization process, the aging population and the digitalization effect. What follows are the strategies aimed at responding to the trends, with the emphasis on their success. These strategies can be adapted in any part of the World, including Croatia.

All of these represent the factors influencing the decline of brick-and-mortar stores. Nowadays, people don’t want to spend their entire weekend on a trip to a faraway hypermarket, wasting it on the buying process and a subsequent return. The modern customer craves access, discounts, convenience stores and e-commerce [12]. The big-box stores are also facing negative margins in non-food category and the lower sales per square meter. Due to these circumstances, most retailers cut the variable costs, decrease the number of personnel, with the results being quite detrimental: poorer service, replenished shelves and stock outs. These decisions, made by retail management, only serve to further deepen the existing crisis, pushing the customers toward the competition and new retail formats.

The dominant EU retail model was price-orientated. The lofty discounters gained the share market of 35% in Germany [13]. They focused on private labels at unbeatable prices. The retail development is based towards the soft-discounting, providing branded goods, interesting store layouts and peculiar buying experience. Nowadays, the customers prefer to obtain value for money. The lowest price, as a buying factor, is reduced in influence and increasingly substituted with “value” and “trust”. The price is no longer a primary purchasing factor, with the customers seeking a fair price, coupled with high quality.

Hypermarkets and supercenters are reducing their market share constantly. The big-box stores are large, usually larger than 5,000 square meters and situated outside of the large cities. They provide food and non-food items, usually at low prices, made possible by scale purchasing.

Their market share is declining in both the Western and Southern Europe, with both at 27% in 2007. In 2008, their market share was 26% and in 2014, it dropped to 22%, according to the retail analyst firm Planet retail. These stores have lost their competitive advantage of low prices and huge selections, because the trends are shifting. Clearly, the management has to take modern consumer behavior into consideration. This section may be divided into subheadings. It should provide a concise and precise description of experimental results, their interpretation as well as the experimental conclusions that can be drawn.

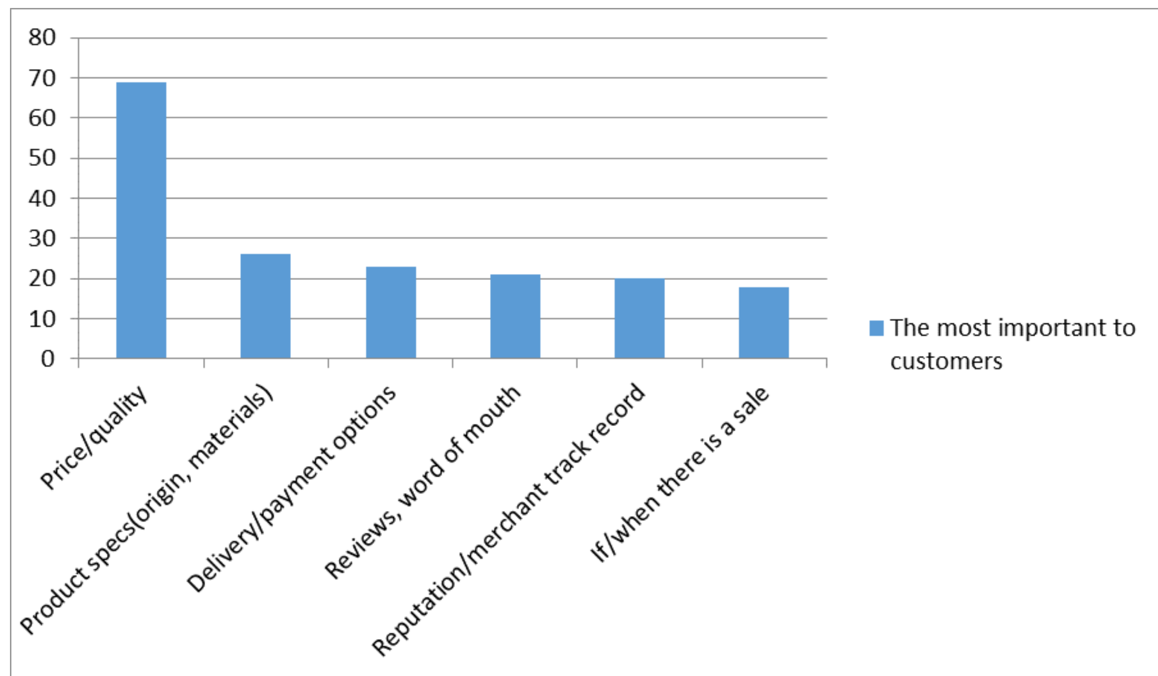

Figure 1. The most important factors influencing purchasing behaviour

In the survey "Retail CMO's guide to the Omnishopper", conducted in 2015, represented in Figure 1, it is noticeable that the discounts and promotions came up sixth (18%), after price/quality (69%), product specifications (29%), payment options (26%), user reviews (21%) and reputation (20%). The modern consumers want a shopping experience, demanding convenience and value. The strategies of supermarkets has, thus far, been based primarily on low prices and low wages. However, this particular trend has changed irrevocably. Currently, the hypermarkets and supermarkets have a market share of 70%. The projection, impacted by all the mentioned factors, predicts a share of 59% in 2025, according to the Planet retail and the Bain analysis. This is a more favourable projection for hypermarkets and supermarkets, with some estimates going as low as 48%. The convenience stores and online markets will, in due time, take over the market and define the retail management [14]. The shift from the big-box stores to the convenience stores has also repercussions on the average grocery store size, as well as the average assortment of goods sold. With all the issues already mentioned, the present average surface stands at 775 square meters. The average surface in retail was constantly on the increase, until recently. The projection for 2025 is quite shocking, with an expected drop of 10%, to a shrunk average store surface of 700 square meters. Some predictions are going so far as to predict even a greater shrinking rate, by 30% to 35%. The overall result will be the reducing of available shelf space. An average number of stock keeping units (SKU), the weighted average assortment size, per channel format, is 8.000. The prediction for 2025 is reducing the available shelf space, dropping it by 15% to 25%, to 6.000 to 7.000 SKUs. The retail companies are also experiencing eroding margins, which have been in effect since the past decade. The reducing SKUs and the newly available shelf space steers the attention of retail companies on the products displayed on the shelves, with the emphasis on the customers' preferences. The lowest price is thus not the most important factor any more. The creation of multi-channel, digital formats is indeed the future of retail management [15].

As can already be seen, the retail leaders are making the necessary changes, in order to satisfy new customers. The French retail company, Carrefour, is going through the most important transformation of its stores. Their focus shifted massively towards the convenience format (from 200 to 900 square meters). By the end of 2015, the Group had 7.181 convenience stores, including 1.070 new stores. In France, the inclusion of the Dia store is the answer to the demand of smaller formats, caused by a more dynamic lifestyle, coupled with the need for a more convenient shopping experience. Currently, they are proceeding at a rate of converting 40 stores a month. By opening the stores in strategic locations, acquiring local retail chains, renovating the existing assets and by developing innovative digital solutions, Carrefour is tailoring its model to the specific needs of each

local area. Although Carrefour has not given up on hypermarkets and supermarkets, nearly 400 new stores were opened under the Market, Bairro and Supeco banners, reaching the total number of 3.462 supermarkets (with the area of 1000 to 3500 square meters), by the end of the year.

At the end of 2015, Carrefour was operating a network of 1.481 hypermarkets worldwide (2.400 to 23.000 square meters), including 61 new stores. Even though Carrefour is opening new hypermarkets and supermarkets, the current business strategy is obvious. Namely, during 2014, 1.070 convenience stores opened, standing in sharp contrast to 461 new hypermarkets and supermarkets [16].

Also, a second French retailer, Auchan, has opened its first "myAuchan" convenience store in Paris, France. The store replaced a former, 300 square meter "A2Pas", with the aim of offering shoppers a reinvented, innovative, multichannel format. The store offers 5,500 SKU assortment of both regular and premium products, along with an improved customer service and a dining corner [17].

As a part of its push to drive online and convenience sales, the German retailer, part of the Schwarz group, Lidl, is reportedly going to open a new "Express" format. This new format will be trialed in Berlin, with the tagline "Always.More.Online". The new format will be smaller than a standard Lidl store, with the product range focused mostly on convenience products. It will also feature several Express checkouts. In order to encourage online shopping, it will offer an in-store pick up service for purchases made online [18].

The modern customer is also concerned about the origin of food and its' sustainability, with health concerns being paramount. As such, the healthier way of life necessitates organic, gluten-free, fresh and locally produced food. In large European cities, where traffic jams are frequent, public transport is available to individuals, the car use is expensive and thus avoided. The environmental concerns are also a factor, with modern customers frequently resorting to buying at a local store. This is the main reason companies operate their convenience stores in growing locations and invent in store amenities, such as an in-store prepared meals, a large selection of fruit and vegetables, as well as organic products.

The Swedish retailer Axfood has become a part-owner of the Urban Deli format, which is a restaurants / food market / specialty store hybrid.

The Carrefour has also started the first "Shop'n Go" car-sharing station and charging point, created in Milan. The initiative is part of an effort to raise customer awareness with regard to the advantages of shared and electric transport, crucial for environmental sustainability, thus promoting eco-sustainable and efficient behaviour in urban areas and particularly major cities, such as is Milan [19].

Numerous companies recognize the importance of online market sales, although the web commerce has been available for the last 20 years has not had a predicted impact on the consumer. The current market share of online sales is just 8.4% of total retail sales [20]. The most popular e-commerce products are clothes and footwear, home electronics and books. The online share is high in non-food categories, however, the average online share of the grocery sector is still quite low, with the possibility of sector growth. The retail companies are undertaking enormous efforts in order to pinpoint the most suitable strategy of attracting customers to purchasing fresh food, fruits and vegetables.

According to the Delloite's study "Global Powers of Retailing 2016 Navigating", there exists a "new digital divide", with one third of the 250 largest market leaders without an e-commerce option. About one-fifth (33 companies) in 2014 did not have a transactional website. This is similar to the 2013 result, but down from more than one-quarter during year 2012, as an increasing number of retailers has launched an e-commerce business. Most of the companies that did not engage in e-commerce are retailers of food and other fast-moving consumer goods (i.e. supermarket, hypermarket, hard discount, and convenience store operators). The reduced profits and margins in hypermarkets and supermarkets are replaced by the digital commerce and the profits made in-store are funneled to the digital transformation efforts. The best-selling products in online trade consists of non-food products, so that particular brand of goods has to be increasingly offered on-line. The food products will thus present the opportunity for the greatest growth. Also, the on-line commerce will accelerate the future

expansion of digital commerce. The present customer is served through all the available channels: stores, mobile, online, and social, making them the omni-channel customers. The omni-channel retail integrates the various different methods of shopping available to consumers (e.g. online, in a physical shop, or by phone), making them in constant contact with the company, essentially being able to pick up where they left off on one channel and continue the conversation on another [21]. Certain customers require fast delivery, some of them want predictable delivery time and others want to pick the products after the work time. Companies have to tailor all the channels in accordance with the customer needs, for the research shows that omni-channel customers spend two to five times more than customers who buy in only one channel [22].

The current business model, one based on distinct, separated business departments within a hierarchical structure can no longer exist. Some traditional companies are trying to implement the omni-channel principle by inventing a "digital department" or a "mobile department", but this alternative has severe drawbacks. Given the fact that a modern customer buys through multiple channels and isn't concerned with the companies' ability to address this particular business challenge, forces the management to unify all of the departments. Companies must thus be effective across with regard to all the functions and channels. These new services and stores emphasize the need for excellent coordination between the departments within a retail company. More than ever before, the management is responsible for coordinating all the functions across the channels. Traditional companies are still afraid of the new trends and do not invest sufficiently.

The supply chain and the planning process has to be effective in order to yield favorable results. According to the 2016 survey, "Retail CMO's guide to the Omnishopper", item unavailability is the most frustrating aspect for customers (at 73%). Therefore, the inventory is the most important factor in creating the shopping experience, more important than information security (59%), the existence of too many choices (48%) or too much information (48%). There has to be a system in place which manages the planning and the supply chain, with orders reflecting on inventory state. Thus, IT investment is in the focus of the retail companies. Without the existence of proper logistics and a responsive IT infrastructure, one covering every aspects of the company business process, the final result will be severely lacking. The multi-channel formats, ones based on the digital transformation process and the creation of smaller formats, such as the convenience stores, have a greater probability of success under these conditions of shifting consumer behavior.

Each company has to start with a clear strategy and vision. The investment in digital transformation has to be accompanied with investment in procurement, marketing, staff, logistics and stores. The entire process, overall structure and technology used has to be in the service of converting the company to a omni-channel format. The conversion requires various skills, seeing how the customer is at the center of attention. The digital transformation emphasizes the service component, therefore, it and is no longer sufficient to just display a product on the shelf and expect it to sell.

In the previous chapter, all the relevant factors influencing the retail industry were considered. Currently, the customer requires a complete buying experience, both in the store and on-line. This is the only option that will ultimately make him/her a loyal customer. The loyalty programs represent an important tool in identifying, rewarding and retaining profitable customers [23]. However, the loyalty is not the sole reason behind the purchase, with the most important factor being the value provided to a customer. Therefore, converting from a simple retail to the omni-channel format must be an all-encompassing venture, presented to the customer only upon successful completion. This process cannot be rushed.

There are seven capabilities a retail company needs to get right in order to serve an omni-channel customer [24]:

- Building web and mobile customer experiences with intuitive interfaces, rich content and a great connection to the physical store experience.
- Building the right assortment across channels in a way that makes the most of each channel.
- Marketing effectively across traditional and digital media channels through media allocation, message and promotion coordination, and optimizing each media channel.
- Developing profitable fulfilment and shipping models.

- Integrating management of inventory across the supply chain, and placing SKUs in the right nodes (stores, distribution centres and fulfilment centres) for rapid delivery at minimum cost.
- Incorporating advanced analytics techniques into day-to-day decision making.
- Building an agile technology development function that is connected to the business and is flexible enough to work across functions.

The retail industry management has a difficult task, to unite all the departments within a particular company. A great example of adopting this new model is Macy's. In 2010, they announced a new, omni-channel strategy. Macy's found that customers who shop across multiple channels are 8 times more valuable than those who shop confined within a single channel. Therefore, the company invested in both the digital commerce, as well as their stores, utilising the stores as distribution centres, shipping items directly to online buyers and filling inventory when items are low in stock. Also, the omni-channel position was created within the company, a person directly responsible to the CEO, not only responsible for the digital transformation process, the stores, mobile and online activities, but also for the logistics, the company's overall systems and operating functions. The financial performance of Macy's, due to the actions undertaken and the importance of this deliberate investment, has improved significantly, gaining in market share and rising their stock for 43.1% in 2013. [25].

Another example of a successful digital strategy implementation is the French retailer Carrefour, which offers its customers a wide range of solutions for ordering, delivery or collection. In Italy, a service called “The clicca e ritira” is available, one constantly expanding, with more than 240 points where items can be picked up within an hour of ordering, or delivered at home within three hours.

The projections made regarding the reduced influence of brick-and-mortar stores show that e-commerce has yet to achieve a 10% share of the total sales volume. The reasons behind this is that consumers still want to socialize and interact with others, therefore, the stores give them the opportunity to chat with other customers or store personnel, spend their time and touch the products. The classic retailers still earn profitable operating margins, ranging from 5 to 11%. The e-commerce cannot substitute an in-store venture, however, it can help a retail company in being more successful, trough combining both the strategies. Both the e-commerce and brick-and-mortar are indispensable, with the companies under conditions of finding a synergic level between the two.

4. CONCLUSIONS

In this paper, three distinct trends are emphasized: the urbanization process, the aging population and digitalization. These trends will inevitably shape the future and affect all the aspects of life, as well as the global retail industry. The aging population is on the increase, with the fertility at its lowest points, especially in Europe. The socioeconomic gap is constantly increasing and in combination with the demographic impact will be impossible to avoid. The migratory trends of urbanization, with the rural population on the decline, make the current strategies of retail companies no longer feasible. Hypermarkets and supermarkets, historically the largest market shareholders, are decreasing and the retail companies are directed towards smaller formats as convenience stores. The price is no longer a primary purchasing factor, value and high quality are the subject of customer’s need. An average modern customer is quite informed, with the loyalty decreasing in relevance. The future of retail depends on both the effective and efficient use of all the available resources. The multi-channel formats, ones based on the digital transformation process and the creation of smaller formats have a greater probability of success in today’s changing world. The digitization process has to be implemented within each company, in a seamlessly and deliberate fashion. The synergy of digitization, the physical stores and management remains as the key to retail companies’ success.

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CORPORATE GOVERNANCE AND ECONOMIC CRISIS IN DEVELOPING COUNTRIES

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A B S T R A C T

The paper analyses influence of global economic crisis on enterprises from developing countries. Analysis is conducted with the goal of determining the reason of crisis and imposing recommendations for mitigation of effects arose from crisis. Main assumption is that irresponsible behaviour of decision makers is the main cause of economic crisis. Due to this, standards and good practice of corporate governance in OECD countries and the Republic of Srpska are analyzed with goal to indicate the omissions in their implementation. Also attitudes of OECD action plan for improvement of corporate governance are presented and recommendations for improvement for state of corporate governance in the Republic of Srpska are imposed.

A R T I C L E I N F O

Keywords:
Corporate Governance, Economic Crisis, OECD, Bosna and Herzegovina

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1. INTRODUCTION

Global financial crises have caused biggest and broadest fall of global economic activity in modern age. In year 2009 most of the large developed economies were in deep recession. Consequences ceased fall of global trade that is drastic fall in size and structure of foreign trade. Due to corporate weaknesses and scandals, investors lost their trust in companies (OECD, 2009).

Corporate governance is a key element for improvement of investors' confidence, increase of competitiveness and improvement of economic growth. Corporate governance is on the top of agenda for international development as stated by James Wolfensohn that "the governance of the corporation is now as important in the world economy as the government of countries (Wolfensohn, 1998). "

Good corporate governance can help to prevent corporate scandals, fraud, and potential civil and criminal liability of companies. Good corporate governance enhances image and reputation of a company and makes it more attractive to investors, suppliers, customers and other stakeholders of the company. There is evidence from many researches that good corporate governance produces direct economic benefit to the company, making it more profitable and competitive.

The paper tries to determine causes that lead to crises, especially ones that lead to current global economic crisis which has started at fourth quarter of 2008 and still lasts. It is assumed that main cause of economic crisis is irresponsible behaviour of decision makers at all levels, especially the business decision makers. Corporate social responsibility, that is efficient and effective corporate governance, might be the solution for getting out and prevention of the crisis.

2. MACROECONOMICAL EFFECTS OF ECONOMIC CRISIS

In science economic crisis is called a period of significant negative development of economy. Other than that, economic crisis is also called existence of negative development and other macroeconomic indicators (e.g. level of price, employment, capital flows). Economic crisis can strike economy of one or several countries, one sector over the world, economy of few countries or whole world economy. Economy which is strike by crisis suffers mostly from consequences of unemployment and impoverishment of population, which can lead to social disturbances. Regarding economic conjuncture, there are three undesirable types (Babić, 2003):

- Stagnation,
- Recession, and
- Depression.

Stagnation is a period in which economy do not increase, which means that output value of economy in some period stays the same. There is no unique opinion about whether a period of stagnation can be considered a crisis or not. Based on universal definition, recession is a period when output value of national economies decreases over the two sequential quarters. Depression arrives when output value decrease for a period more than two sequential quarters.

Figure 1 shows output values for economies of developing and developed countries for the period from 1961 to 2011, with crisis period shown cyclically.

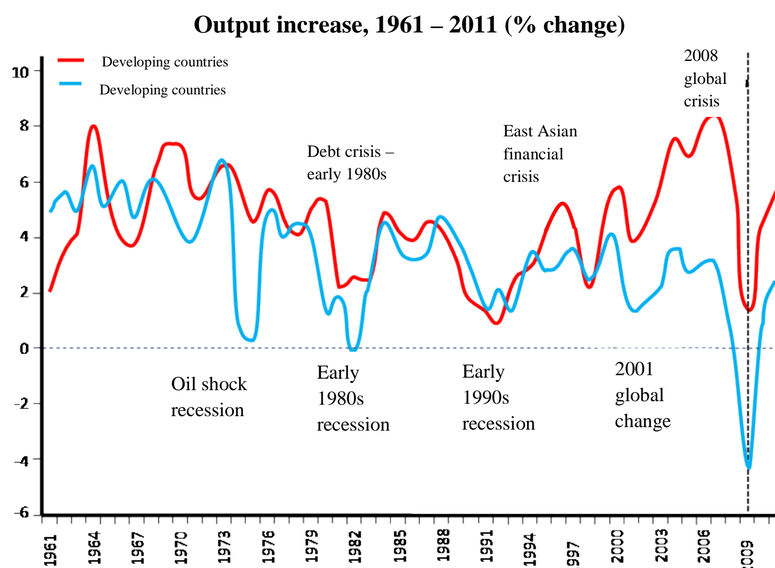

Figure 1. Output value increase for economies of developing and developed countries

(Source: Prof. dr Besim Ćulahović, World economic crisis: implications and solutions for Turkey, Bosnia and Herzegovina, and West Balkan)

On one hand, it can be disproportion between supply and demand in one national economy, and that is when demand falls below the level of supply of goods, so one part of goods stays unsold, in other words do not find the way to customers. This can be consequence of distrust of customers' in future economic development (e.g. perspectives for economic growth, safety of work, etc.). On other hand, negative effect on economy growth can have large natural disasters, threat of war or terrorist attacks, etc. Equivalently, shortage of resources (e.g. in form of oil shocks) can lead to abstain of consumers from purchasing, which can cause negative growth of economy. According to followers of John Maynard Keynes theory, country's demand for goods has large impact on total economy movements; if country decrease its expenditure or increase taxes, it can through multiplication factor lead to decrease of total demand and can cause or increase economy crisis. Growth crisis can be also caused by foreign supply: non utilization of potential capacities (so called structural crisis) can lead to earlier mentioned insecurity of customers and decrease of total demand.

3. IRRESPONSIBLE BEHAVIOUR – CAUSE OF CRISIS

World economic crisis has its roots in total collapse of financial system which happened in fourth quarter of 2008. Amazing is the speed by which crisis has spread over the world and seriousness of its impacts on sectors of economies. Consequences of financial sector mistakes also devastate other sectors of economies. In them market economy has unrealistically function, short term funds have multiplied quickly and irrational wealth was created. Crash arose after the decade of cheap money, large growth,

easy acquired loans and related inflation of asset and real estate values. Participants: commercial banks, investment banks, central banks, regulators/supervisors of banks and agencies for assessment of credit ability – all of them have to accept its part of guilt. Rules that regulate markets, especially financial markets, were inadequate, unsuitable or simply were not applicable in practice. Organs of public authority seem to be not aware of this behaviour and large risk taken by financial institutions. Figure 2 shows effects of economic crisis at the end of 2008 on the decrease of industrial production of leading world economies.

Same analysts believe that crisis would not happened if from its beginnings stakeholder model was used instead of solely protecting shareholders and owners of capital. This means that irresponsible behaviour is main cause of economic crisis, which arise on malversation, doing business without coverage, non transparency as well as on consideration of interests of one small group of stakeholders.

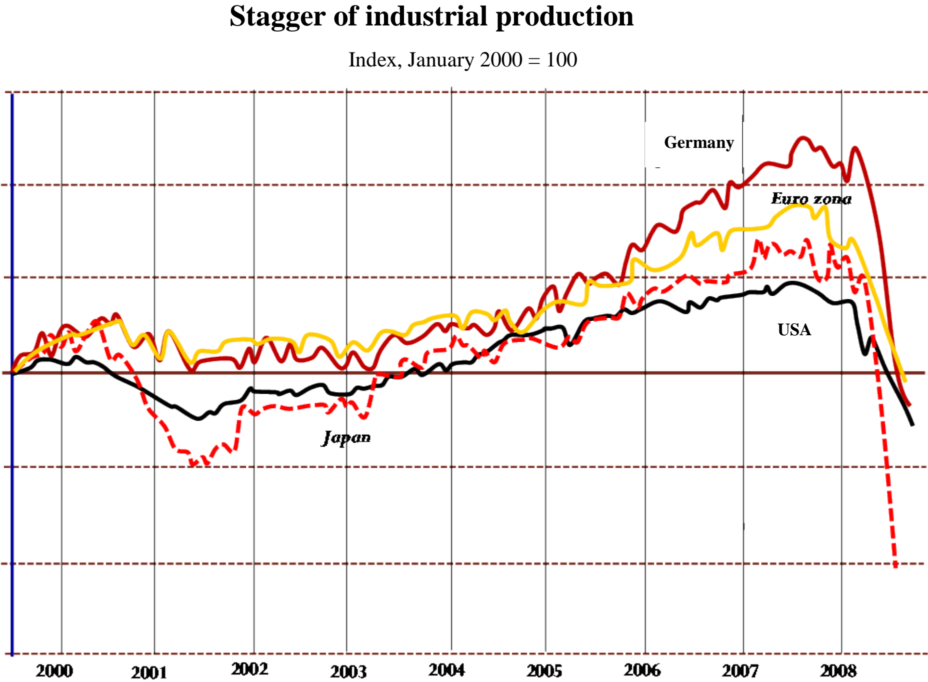

Figure 2. Stagger of industrial production of leading world economies

(Source: Prof. dr Besim Ćulahović, World economic crisis: implications and solutions for Turkey, Bosnia and Herzegovina, and West Balkan)

3.1. Irresponsible behaviour of investors

Beside mentioned, crisis has confirmed that investors are ready to reward managers of companies which generate large profits in high-risk businesses.

Few years before crisis, France bank BNP Paribas has implemented its own highly conservative system of risk and liquidity control (stricter than regulatory requirement of Basel II). Due to this highly conservative conduct, profits of BNP Paribas have for few quarters lag behind its European competition, Deutsche Bank and Societe Generale. BNP Paribas has endured critics of financial public due to decrease of its profitability and stagnation of share price, which can be interpreted as a shareholders' pressure to change management politics.

Shares of two largest competitors have recorded higher value due to larger profitability. But only few quarters later financial crisis had larger impact on Deutsche Bank and Societe Generale than on BNP Paribas.

During crisis it became obvious that conservative conduct gave bank much better position regarding its competition. But only few quarter earlier investors have rewarded managers of Deutsche Bank and Societe Generale for generated profits, irrespective of that those profits were generated from highly risky businesses, while management of BNP Paribas were punished with stagnation of share value.

Second example is case of AIG (American International Group), which managers were rewarded for many years with increase of share price based on high profits they generate from highly risky businesses, which in the end caused a beginning of financial crisis.

3.2. Consequences caused by crisis

If we now compare it to Max's writings about crisis, especially cotton industry crisis from 1861, as well as data of P. T. Ellsworth regarding the crisis from 1929 it is easy to note two key characteristic from both periods:

- In both cases it is case of phenomenon of excessive production, excessive investments, that is overproduction just before the crisis occurred;
- In both cases there is a problem of placement of goods just before the crisis and during the crisis.

However, if main cause of crisis is not shortage, but past excessive consumption of all subjects in society: public sector, nonfinancial sector, financial sector, households, by writing of J. Taylor (2009), J. Stigltz (2007), J. Crotty (2008), International Herald Tribune (2009), The Economist (2009) lays a question: were they behaving responsible?

Customers act on irresponsible behaviour so placement of goods is difficult. Figure 3 shows level of customers' trust of seven largest OECD economies in period from 1978 to 2009.

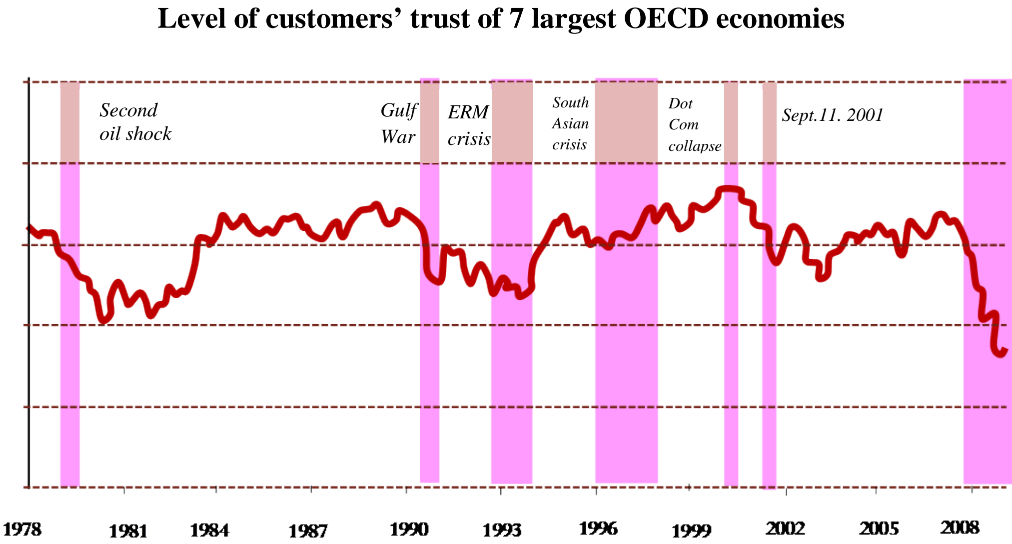

Figure 3. Customers' trust in economies

Source: OECD Report for year 2009

Every crisis is followed by: large discharge of employees, large financial losses, large economy losses on national and global level and large crisis in inventors' trust.

Common lines of every crisis are: fraud, absence of supervision and enforcement of laws, greediness, etc.

4. ROLE OF CORPORATE GOVERNANCE IN CRISIS

Although most of weaknesses of corporate governance primary affect companies from financial sector, it also affects all corporations which are listed on the Stock Exchanges. Due to this, overcoming weaknesses of corporate governance is key element of efficient response to crises and one of the main goals of international initiatives.

Considering the role of standards of corporate governance, the OECD has indicated several weaknesses. Many corporate governance tools proved to be ineffective faced to unexpected pressures and strong conflict of interests. The most important corporate governance failures are mostly due to implementation gap of existing rules and standards. While certain rules and regulations can be improved, regulatory agencies must increase control over the companies. The OECD action plan on Corporate Governance

has included consultations with a broad range of representatives from non- OECD countries, the private sector, other stakeholders and civil society. Main areas for improvement should be concerned with:

1. The governance of remuneration:
   - Decision making,
   - Incentive system designing, and
   - Transparency.
2. Implementation of effective risk-management:
   - Board responsibility,
   - Relevance and Independence of risk managers, and
   - Disclosure of risk policy.
3. The quality of board practices:
   - Competence,
   - Independence, and
   - Transparency.
4. The exercise of shareholders rights:
   - The role of shareholders,
   - Institutional investors activism, and
   - Enforcement of shareholder rights.

5. ROLE OF CORPORATE GOVERNANCE IN CRISIS

Results of implementation and compliance of principles of corporate governance for companies from the Republic of Srpska for year 2010, shown in Figure 4, are determined using Scorecard analysis. The Scorecard for the Standards of governance of Joint Stock Companies was developed by the Banja Luka Stock Exchange with the assistance of the International Finance Corporation (IFC) based on the model of the Scorecard for German corporate governance for evaluation of the implementation of (good) practices and principles of corporate governance (The Banja Luka Stock Exchange, 2009).

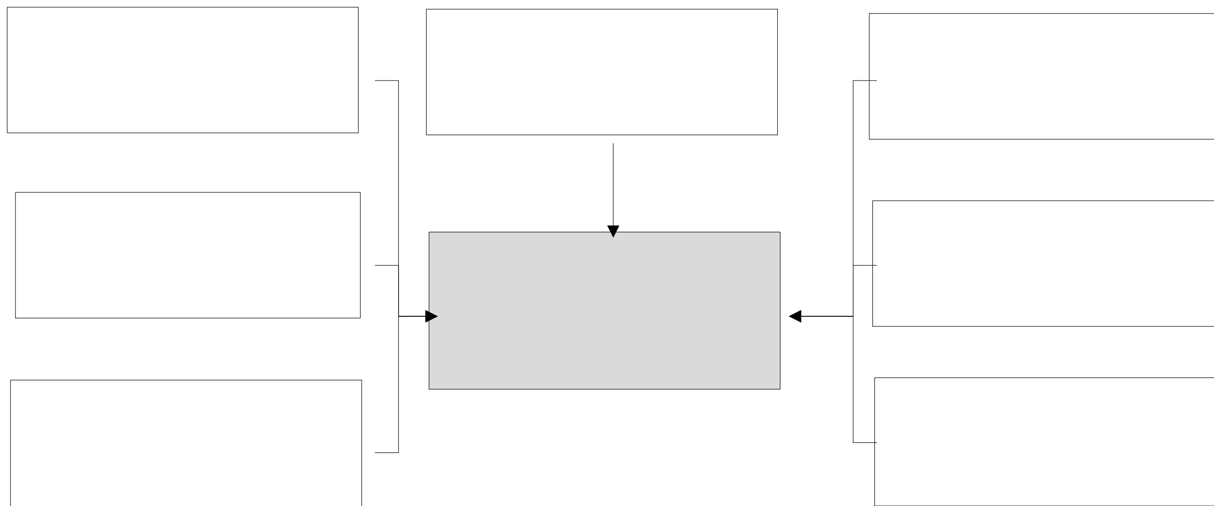

Figure 4. Results of Scorecard analysis for evaluation of the implementation of practices and principles of corporate governance for companies in the Republic of Srpska

Total score of the implementation of practices and principles of corporate governance for companies in the Republic of Srpska is 53.46% which shows that implementation of principles of corporate governance in these companies are not on satisfactory level, taking into account that companies that apply basic principles of corporate governance should have the score between 65% - 75%. Particularly low level is showed in commitment to the corporate governance standards, role and responsibility of boards, disclosure and transparency of information and rights and treatment of shareholders.

These results indicate that state of corporate governance in companies from the Republic of Srpska is not on satisfactory level, and that implementation and compliance with principles of corporate governance is in primary phase. Low level of implementation and compliance with principles of corporate governance increases business risks, lowers company's completeness, and also increases investment risks for potential investors.

There are also many segments which companies should improve in order to bring the state of corporate governance on satisfactory level, to lover business risks and to attract new investors and raise capital at lower price.

6. CONCLUSION

Not even leading economic experts agree why crisis happened, what are its roots and what are possible consequences. Same analysts believe that crisis would not happened if from its beginnings stakeholder model was used instead of solely protecting shareholders and owners of capital. This means that irresponsible behaviour is main cause of economic crisis. Destructive effects of crisis will demand drastic measures and large changes in behaviour and business activities in the world market.

OECD has, in its action plan for improvement of corporate governance, stressed importance that world economy must move towards corporate social responsibility with a goal of protection from future crisis. Corporate social responsibility is simply making strategic decisions, decisions that consider the broadest impacts and consequences, transparency, concern for brother social interests and everything else that will ensure safe future economy in years to come.

By analysis of state of corporate governance in companies from the Republic of Srpska it was determined that these companies have low level of corporate governance, which as a result has poor rating of companies and low level of investors' confidence.

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