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CORPORATE GOVERNANCE, THEORY AND IMPLICATIONS IN HOSPITAL MANAGEMENT

(An introductory paper on Public-Private corporate governance, Management, CEO, Board of Directors, Hospital Characteristics, CEO duality and its implication on governance.)

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1. INTRODUCTION

Corporate governance has important implications on the micro economic as well as the macro-economic level, where poor corporate governance can result in the failure of corporations, as in the case of the two big giants, Enron and Worldcom. The most common instruments in implementing corporate governance include board of directors, independent directors, board size, CEO, managers, efficient market, political regime, government, regulatory authority and judiciary (1, 2).

The independent directors, CEO, board of directors and managers can improve the value of a firm by performance of their fiduciaries. The role of the regulatory authority, government and judiciary is important to improve the value of a firm as these authorities can protect the rights of the shareholders and implement corporate governance in developing as well as developed financial markets. Corporate governance has significant impact in disciplining a powerful and independent CEO, bringing improvement to the value of a firm in developing and developed markets. Similarly, the board and CEO can also safeguard the interest of the shareholders by creating more value for them (3-4)

1.1 Aims of this paper review

While the term "governance" is increasingly being used to draw attention to a number of factors that affect the quality, effectiveness and reach of social services, no consensus has emerged on definitions, frameworks and, in particular, how it applies to the health sector (5).

The aim of this paper series is to introduce and give a panoramic view (drawing on existing work from the health sector and broader management and governance literature) of some more relevant concepts of corporate governance and management applied to healthcare sector, Public/private health sector, performance determinants, CEO duality, Board independence, Agency theory, Stewardship theory etc.

Rather than asking whether a particular health care system has the right inputs or produces the right outputs, questions about *governance* aim to identify factors that influence the behavior of the system, such as rules or procedures that are expected, in turn, to be associated with better performance and outcomes.

In this first paper we will deal with some introductory definitions of governance and discuss exclusively the CEO- Board Size, Hospital Characteristics, CEO duality and its implication on governance.

2. Governance- a relevant definition, Distinguishing private & public sector

Governance can be analyzed at the broadest level in terms of political actors who contest and collaborate to establish each society's particular public policies. Governance can also be analyzed at a secondary level in terms of the forms of these specific public policies, that is, the resulting rules, institutions, laws and enforcement mechanisms. However, governance can also be analyzed at the level of particular organizations, for example, the governance of a social security institute, a district health *system or a hospital.*

-The literature on ***private corporations*** initially focused on governance in terms of the relationship between ***shareholders and managers***. This literature sought to understand what "governs" the

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behavior of corporate managers who, over the courses of the 19th and 20th centuries, displayed increasing autonomy from their companies' owners.

According to OECD (6) corporate governance is: "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring".

-The literature on ***governing public sector*** agencies mirrors the private corporation literature in many ways, with the roles of shareholders and managers replaced by citizens and public officials. Like the literature on corporations, these studies also focus on governance as a set of relationships, goal-setting processes, and incentive structures. *However, public sector agencies face a number of additional issues because they* ***respond to a larger number of interest groups***. When an organization answers to multiple groups, the ability of any one group to achieve its goals is diluted and the resulting organizational performance is influenced by contesting principals (7, 8).

2.1 Governance and Health Sector

The term "governance" has entered the ***health sector literature*** in different ways, paralleling and influenced by these other bodies of work. As in the corporate and public sector literature, part of the health sector literature has looked at governance from the perspective of relationships among actors as they influence the behavior of specific organizations such as hospitals or mandatory health insurance institutions (9. 10)

Much as the corporate and public sector literature was extended to include broader social goals, another stream of work in the health sector has emphasized the broader notion of governance, particular using the concepts of stewardship or steering (11). Anyway, governance of public hospitals in Europe for example is changing. Individual hospitals have been given varying degrees of *semi-autonomy within the public sector* and empowered to make key strategic, financial, and clinical decisions themselves. This implies much more flexible and integrated levels of decision making,

2.1Hospital characteristics ,CEO-Board of Directors, CEO duality; Implications on governance

Brickley and Van Horn (12) estimate the relations between CEO turnover and hospital performance and between CEO pay and hospital performance, using a sample of nonprofit hospitals between 1993 and 1995. They find that the relation between CEO turnover and hospital performance is statistically indistinguishable from that for a sample of for-profit hospitals, and that the relation between CEO pay and hospital performance is similar to previous estimates from a sample of publicly traded firms.

Other work on hospital governance and management includes Alexander et al. (13), which finds that *physician representation and voting rights on boards* is higher among for-profit hospitals than others. Boeker and Goodstein (14) find that low occupancy rates increase the likelihood of changes in board composition. Judge and Zeithaml (15) indicate that board size, diversification, and insider representation are negatively related to measures of board involvement, while organization age and return on assets are positively related to these measures. Beekum, Stedham and Young (16) use a 1989 survey on hospital governance by the American Hospital Association and perform cross-sectional analysis of 167 California hospitals. They find that board size and diversity are related to board emphasis on financial outcomes. Using the same data, Young, Stedham, and Beekun (17) find that boards with independent chairpersons are more likely to adopt a formal CEO evaluation process. Young (1996/97)uses a sample of California hospitals between 1980 and 1991 and finds that insider representation is associated with less charity care (uncompensated care) among hospitals in relatively weak financial condition as well as those in highly competitive markets

2.1.1 Governance and CEO duality

A corporate is said to have a dual CEO when the CEO functions simultaneously as the chairman of the board. CEO duality has received considerable attention in the literature on corporate governance and firm strategy (18). Much of this attention arises from the belief that CEO duality would make a difference to firm performance and corporate governance (this is applied mostly to private sector).

There is controversy surrounding how CEO duality affects the firm. Interest groups that oppose CEO duality such as shareholder activist groups, and

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corporate governance watchdogs suggest that CEO duality may adversely affect firm performance because the duality structure would reduce the board's ability to govern, which is its primary function. Following this argument, rationally a question raises "If the board of directors is really there to represent the interests of the stockholders, what is the chief executive doing on the board? Doesn't he have a conflict of interest? He's the professional manager. He cannot represent the shareholders and impartially sit in judgment on himself.

When the chairman of the board and the CEO is the same person, it becomes more difficult to hold the chief executive officer of the firm accountable for his/her actions and consequently firm performance might suffer. Scholars (19) suggest that CEO duality "signals the absence of separation of decision management and decision control" which would cause "the organization to suffer in the competition for survival." CEO duality has been blamed for the poor performance of firms such as Sears, Westinghouse, General Motors and IBM (20). In defense of CEO duality, Anderson and Anthony (18) argue that it provides "a single focal point for company leadership" with a potentially clearer organization mission and strategy. According to this viewpoint CEO duality lends stability and continuity to the organization which in turn would lead to superior firm performance.

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