

Institutional Logics of Corporate Governance

Abstract

Purpose: Zajac and Westphal (2004) argue that there are two institutional logics of corporate governance: Corporate Logic and Investor Logic. This paper examines how Corporate Logic and Investor Logic are embedded in public discourse on corporate governance.

Design/methodology/approach: A selection of codes of practice and corporate annual reports from Australia, New Zealand and the United Kingdom are sampled. Extracts from the sampled texts are collected and analysed. These extracts relate to eight aspects of corporate governance (including incentive schemes and performance measures).

Findings: Public discourse on corporate governance is consistent with both Corporate Logic and Investor Logic. Investor Logic is more deeply embedded in the sampled codes of practice than Corporate Logic; whereas both logics are deeply embedded in the sampled corporate annual reports.

Theoretical implications: Despite Corporate Logic and Investor Logic have opposing assumptions about human behaviour and implications for corporate governance, these logics appear to have merged into a new institutional logic.

Paper Type: Empirical

Key words: Corporate governance; Institutional theory; Discourse analysis

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1. Introduction

This paper examines how Corporate Logic and Investor Logic are embedded in public discourse on corporate governance as represented by codes of practice and corporate annual reports. Corporate Logic asserts that directors and executives are knowledgeable professionals that can be trusted by stakeholders to act in their best interests (Zajac and Westphal, 2004). By contrast, Investor Logic asserts that executives are self-interested, independent directors should be appointed to control executives, and financial incentives are necessary to align the interests of executives with those of shareholders (Zajac and Westphal, 2004). This research is not concerned with the empirical validity of these knowledge claims. Instead, this research is concerned with how institutional logics are embedded in public discourse. Institutional logics are beliefs, ideas, norms, rules and values that are a coalescing discourse with a durable meaning, which materially influences organisational behaviour (Thornton et al., 2005). While Zajac and Westphal (1995; 2004) only examined a few aspects of corporate governance, this research examines many aspects of corporate governance in order to understand how Corporate Logic and Investor Logic influence organisational behaviour.

This paper is organised as follows. The literature on institutional theory, discourse theory and institutional logics is reviewed in section 2. In assessing prior research, a gap in knowledge is articulated. How this gap is studied is discussed in section 3. This includes a description of the research questions and method. Section 4 presents the findings from the discourse analysis of three codes and three corporate annual reports. The findings closely examine the consistency between the theoretical conceptions of Corporate Logic and Investor Logic and the principles and recommendations in codes and policies and practices in corporate annual reports. A discussion of the findings is presented in section 5, and considers how both logics can co-exist in public discourse despite having opposing implications for corporate governance. Concluding comments are drawn in section 6.

2. Literature Review

Institutional theory has traditionally sought to explain how and why organisations in the same industries become homogeneous over time (DiMaggio and Powell, 1983). Homogeneity amongst organisations occurs as organisations conform to societal expectations. Institutions are societal expectations that have become taken-for-granted or ingrained in society. By conforming to societal expectations, organisations reproduce and empower institutions. There are three institutional pressures that compel organisations to conform (Scott, 2008). Organisations are subject to: First, coercive pressure through laws and law enforcement; Second, normative pressure through codes of practice and certification by professional bodies; Third, mimetic pressure through people's desire to imitate others. However, organisations are not slaves to institutions; organisations may symbolically conform to or resist institutional pressures. Further, institutional theory does not rule out heterogeneity amongst organisations. For example, heterogeneity can arise when institutional pressures are weak or conflicting.

Discourse theory is the study of how people use language to interpret and construct their social reality (Alvesson and Kärreman, 2000). Language encompasses all talk and texts, whereas discourse is a subset of language that has a durable meaning and influences the behaviour of individuals and organisations. Further, discourse defines power relationships and knowledge claims in society (Phillips, 2003). Embedded in discourse are beliefs, ideas, norms, rules and values, which are learnt and reproduced through talk and texts, particular in the context of organisational discourse. Organisations are both enabled and constrained by discourse, particularly Grand Discourse and Mega-Discourse (Alvesson and Kärreman, 2000). These are highly integrated and ordered sets of language that represents the taken-for-granted or universal way of talking, writing and acting. Thus, Grand Discourse and Mega-Discourse are akin to institutions (Phillips, 2003; Schmidt, 2010). Through the production and consumption of texts, organisations can influence and are influenced by institutions or Mega-Discourse (Phillips et al., 2004).

At the intersection of institutional and discourse theory are institutional logics, which Thornton and Ocasio (1999, p.804) defined as “the socially constructed, historical patterns of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality.” Societal institutions include the corporation, market, state, family, profession, and religion (Friedland and Alford, 1991), and these institutions are defined and shaped by a range of institutional logics within different societies or countries (Thornton et al., 2005). Institutional logics define what organisational behaviours are and are not socially expected and desirable. However, institutional logics can change over time as new ways of thinking and acting challenge existing institutions. For example, Thornton et al. (2005) found that

public accounting transitioned from Fiduciary Logic to Corporate Logic as growing revenues and profits become the mission of accountancy firms following World War II.

Zajac and Westphal (2004) argue that there are two institutional logics of corporate governance, namely Corporate Logic and Investor Logic, which define and shape corporate governance systems that are both internal and external to the corporation. Rooted in stakeholder theory (Donaldson and Preston, 1995; Freeman et al., 2004) and stewardship theory (Donaldson, 1990; Davis et al., 1997), Corporate Logic asserts that management (directors and executives) are trustworthy and have the specialist expertise to govern and manage corporations in the best interests of all stakeholders. By contrast, Investor Logic asserts that management, in the absence of controls and incentives, will act opportunistically. Only investors, through the invisible hand of capital markets, can monitor and discipline management to ensure that shareholder value is maximised. This is rooted in agency theory (Jensen and Meckling, 1976; Fama, 1980). Based on opposing assumptions about human behaviour and the corporate objective, Corporate Logic and Investor Logic have opposing implications for corporate governance, which are summarised in Table 1.

The eight aspects of corporate governance that are reviewed in Table 1 build on Zajac and Westphal's (2004) theoretical conceptions of Corporate Logic and Investor Logic. Given a positive view of human behaviour and a stakeholder-oriented corporate objective, Corporate Logic implies that non-executive directors will be strategic advisors to executives. Vertical and horizontal equity (e.g. comparable to others in similar roles, but fair to employees and other stakeholders) will be the primary determinants of the remuneration of non-executive directors and executives. Internal (financial and non-financial) performance measures will be

used to assess the performance of executives, who may receive modest bonuses in recognition of their commitment and loyalty. By contrast, Investor Logic has a negative view of human behaviour and a shareholder-oriented corporate objective. To monitor executives, non-executive directors should be financially independent of the corporation. As capital markets are efficient, external (market-based) performance measures (e.g. total shareholder return) are not as easily manipulated by executives as internal performance measures. Contingent on external performance measures, financial incentives for executives are necessary to align their interests with those of shareholders.

Table 1: Theoretical Conceptions of Corporate Logic and Investor Logic

Aspects of Corporate Governance	Corporate Logic	Investor Logic
Human behaviour	Executives are trustworthy and motivated by intrinsic and extrinsic rewards	Executives are opportunistic and motivated by extrinsic rewards
Corporate objective	Stakeholder value maximisation	Shareholder value maximisation
Independence of the board of directors	Both non-executive and executive directors should be independent of mind	Board should comprise of a majority of non-executive directors, who are financially independent
Role of the board of directors (particularly, non-executive directors)	The board (and non-executive directors) is a strategic advisor to executives	The board (particularly non-executive directors) is a monitor and judge of executives
Role of the remuneration committee	The remuneration committee is a strategic human resources advisor; it has to ensure there is a balance of intrinsic and extrinsic rewards for executives.	The remuneration committee (comprising of entirely independent directors) is an evaluator of the performance of executives; it has to ensure that incentives are designed to align executives' interests with those of shareholders.
Remuneration policies and practices for non-executive directors	Fees; Retirement payments	Fees – Cash and shares; No retirement payments
Remuneration policies and practices for executives	Mainly fixed remuneration. Increases depend on stakeholder value and comparisons with other executives.	Mainly variable remuneration including short- and long-term incentives. Increases depend on shareholder value.
Performance measures for evaluating executives	Financial and non-financial	Financial and market-based measures

Zajac and Westphal (1995; 2004) found that there has been a transition from Corporate Logic to Investor Logic amongst US corporations. When US corporations adopted long-term incentive plans, Zajac and Westphal (1995) found that justifications of these plans were

consistent with both Corporate Logic and Investor Logic. Consistent with Corporate Logic, long-term incentive plans may be adopted to attract and retain talented executives; whereas consistent with Investor Logic, long-term incentive plans may be adopted to align executives' interests with those of shareholders. While the choice of justification was dependent on the power of the board and firm performance, justifications consistent with Investor Logic become more common over time. Further, Zajac and Westphal (2004) found that investors reaction to the adoption of stock repurchase plans changed from negative in the early 1980s to positive in the mid 1980s, irrespective of these plans being implemented. Consistent with Investor Logic, investors reacted favourably to stock repurchase plans as such plans represented management's intention to return free cash flows to the capital markets. This is inconsistent with Corporate Logic because stock repurchase plans represent an admission by management that they do not have any future investment opportunities.

Crombie (2009) and Crombie et al. (2010) challenge Zajac and Westphal's (2004) conclusion that there has been a transition from Corporate Logic to Investor Logic. In a study of the largest 50 US corporations, Crombie et al. (2010) found that justifications of the Chief Executive Officer's (CEO's) remuneration in 1998 and 2007 proxy statements were consistent with both Corporate Logic and Investor Logic. Contra to Zajac and Westphal (1995), they found that the presence of these justifications increased over time to the point of where almost all proxy statements contained the same set of justifications. Similarly, Crombie (2009) found the same pattern of diffusion in the annual reports of the largest 50 publicly listed companies in Australia, New Zealand and the United Kingdom. These findings indicate that both Corporate Logic and Investor Logic have become the taken-for-granted ways of justifying executive remuneration or institutionalised discourse.

Crombie (2009) and Crombie et al. (2010) also studied codes of practice on corporate governance. These are mainly produced by regulators, stock exchanges, investors' associations and directors' associations. Codes often include principles and recommendations on executive remuneration. Both studies found that justifications of remuneration are diffused first in codes and then in corporate annual reports (or proxy statements), indicating that codes are the manifestation of coercive and normative pressure. Further, these justifications of remuneration are consistent both Corporate Logic and Investor Logic. Interpreted through Phillips et al.'s (2004) discursive model of institutionalisation, this evidence shows that texts are influential and corporations can gain legitimacy (or attest to their conformance to societal expectations) through their corporate annual reports. However, Crombie (2009), Crombie et al. (2010) and Zajac and Westphal (1995; 2004) did not examine how deeply embedded Corporate Logic and Investor Logic are in the discourse on corporate governance because only justifications of executive remuneration are studied.

3. Research Method

This research "tries to explore the ways in which the socially produced ideas and objects that populate the world are created and maintained" (Phillips, 2003, p.222). In doing so, this paper has two objectives: first, to map and analysis the discourse on corporate governance within codes of practice and corporate annual reports; second, to examine the extent to which Corporate Logic and Investor Logic are embedded in this discourse. While previous research has studied a few aspects of the discourse across many organisational texts, this research investigates many aspects of the discourse across a few organisational texts. Consequently, my epistemological position is interpretive structuralism and methodological position is qualitative. Through a discourse analysis (Alvesson and Kärreman, 2000), this research examines the discourse on corporate governance from a macro or long-range perspective in

order to contextualise Corporate Logic and Investor Logic. This approach will enable me to gain a deeper, richer understanding of these institutional logics (Bryman and Bell, 2003).

The sample of organisational texts is drawn from Crombie's (2009) sample. While Crombie (2009) sampled a range of organisational texts produced between 1991 and 2008, this research samples organisational texts that were produced in recent years because these texts are more likely to be shaped by both Corporate Logic and Investor Logic. One code of practice and one corporate annual report from Australia, New Zealand and the United Kingdom are sampled; six texts in total.

The sampled texts include three codes, namely: Financial Reporting Council's (2006) Combined Code from the UK ('FRC Code'), ASX Corporate Governance Council's (2003) Principles of Good Corporate Governance and Best Practice from Australia ('ASX Code'), and Securities Commission's (2004) Corporate Governance in New Zealand: Principles and Guidelines ('SecCom Code'). These codes are selected because they are the most influential and prominent. FRC Code and ASX Code are legally enforceable. Listed companies must disclose in their annual reports if they comply with these codes or explain why they do not comply. SecCom Code is not legally enforceable, but is still influential as it was produced by a Government agency.

The sampled texts also include three corporate annual reports, namely: Legal & General Group plc's *2007 Annual Report* from the UK ('L&G Report'), Wesfarmers Limited's *2007 Annual Report* from Australia ('Wesfarmers Report'), and Hallenstein Glasson Holdings Limited's *2007 Annual Report* from New Zealand ('H&G Report'). Two criteria were used to select these corporate annual reports. First, the companies selected had to be listed on only

one stock exchange to minimise the influence of foreign codes. Second, the companies selected should be representative of the largest 50 listed companies, where representative means that the corporate annual report includes the average number of justifications of remuneration (as reported in Crombie, 2009). L&G Report, Wesfarmers Report and H&G Report were randomly selected from companies in the sample that met these criteria.

Phillips (2003, p.223) argues that, “Discourse analysis... is the structured and systematic study of collections of interrelated texts and the processes of their production, dissemination, and consumption.” Both codes and corporate annual reports are sampled because these texts are interrelated; for example, the dissemination of codes influences the production of corporate annual reports (Crombie, 2009). This discourse analysis examines the principles and recommendations in codes and policies and practices in corporate annual reports. By systematically studying the consistency between the theoretical conceptions of Corporate Logic and Investor Logic and the discourse on corporate governance in the codes and corporate annual reports, this paper reveals the extent to which these institutional logics are embedded in the texts. However, it may be that the institutional logics are not deeply embedded in the texts. The principles and recommendations in codes and policies and practices in corporate annual reports may be ambiguous, conflicting or superficial. Therefore, four possible outcomes are considered: Corporate Logic only; Investor Logic only; both Corporate Logic and Investor Logic; no (or another) logic.

As defined in Table 1, eight aspects of corporate governance that may vary between Corporate Logic and Investor Logic are studied. These aspects of corporate governance are the most prominent in academic discourse on corporate governance and provide a clear distinction between institutional logics. The discourse analysis involved multiple close

readings of the texts. All phrases, sentences and paragraphs that are related to these aspects of corporate governance were collected from the texts, and then analysed for consistency with both Corporate Logic and Investor Logic. In some cases, there were insufficient quotes from the texts on several aspects of corporate governance for any conclusion to be made. But in most cases, the quotes from the texts were highly consistent with Corporate Logic, Investor Logic or both logics.

The main limitation of this research is that the analysis of the quotes from the texts relies on the subjective interpretations of the researcher. This is unavoidable in discourse analysis. However, quotes from the texts are presented in this paper, so that the readers of this research can re-interpret my findings and conclusions. Of course, it can be argued that I have chosen to include only those quotes that fit with my argument. This is why a detailed analysis of the texts is available upon request. Further, confirmation bias may have led me to choose only those quotes that fit with Corporate Logic and/or Investor Logic. While there are many institutional logics that influence organisational behaviour (Thornton et al., 2005), Corporate Logic and Investor Logic were not chosen prior to the research beginning. These institutional logics emerged as I undertook through multiple close readings of the texts. Therefore, this main limitation has been, to some extent, mitigated.

4. Findings

An overview of the codes and corporate annual reports is given in Table 2. Two aspects of the texts are studied. First, the proportion of the texts dedicated to corporate governance and remuneration is calculated.¹ A comparable proportion of the codes are dedicated to corporate governance, but SecCom Code has a lower proportion dedicated to remuneration than the

¹ Note that words are not double counted; any words about remuneration found in sections on corporate governance are counted as part of remuneration. Also note that remuneration includes words about non-executive directors, executives and other employees.

other codes. Notably, SecCom Code only has 494 words on remuneration, while FRC Code has 1,173 words and ASX Code has 2,091 words. A comparable proportion of the corporate annual reports are dedicated to corporate governance and remuneration, but H&G Report has much fewer words on these matters than L&G Report and Wesfarmers Report. H&G Report only has 1,042 words on remuneration, while L&G Report has 7,383 words and Wesfarmers Report has 7,182 words.

Second, the remuneration principles or policies espoused in the codes and corporate annual report are reproduced, and the six remuneration rationales studied are typically part of these principles. Principles are fundamental beliefs or propositions on which recommendations or practices are derived. In both the codes and corporate annual reports, a common set of justifications of remuneration are found in the principles on which the recommendations in codes and practices in corporate annual reports are based. Typically, these principles are: to attract and retain talented executives; to pay executives at a competitive level in the market; and to link executive remuneration to firm performance. However, these principles are general (or non-specific) in nature. This affords decision-makers much flexibility in determining remuneration recommendations and practices as is shown in the remainder of this chapter.

The remuneration principles and policies from the codes and corporate annual reports are broadly consistent with both logics. Consistent with Corporate Logic, executives are depicted as being high-quality or talented, rather than opportunistic. However, L&G's policy does imply that incentives are necessary to align executives' interests with those of shareholders, which is consistent with Investor Logic. Fairness, in the broadest sense of the word, is emphasised as executive remuneration ensures horizontal equity (between executives) and

vertical equity (executives compared to employees and shareholder returns). This is also consistent with Corporate Logic. But consistent with Investor Logic, the remuneration policies assert that executive remuneration should be dependent on firm performance. However, these remuneration policies are also non-specific. Further analysis is required to determine whether this consistency with both logics remains as these policies are elaborated and applied in the texts.

Table 2: Overview of Selected Texts

	Word Count	Remuneration Principles or Policies
Codes of Practice		
UK: FRC Code (2006)	<ol style="list-style-type: none"> 1. Total: 7,669 words 2. Corporate Governance (CG): 6,255 words (82%) 3. Remuneration (REM): 1,173 words (15%) 	<p>“Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors’ remuneration should be structured so as to link rewards to corporate and individual performance.” (p11) “There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.” (p.12)</p>
AU: ASX Code (2003)	<ol style="list-style-type: none"> 1. Total: 16,686 words 2. CG: 14,102 words (85%) 3. REM: 2,091 words (13%) 	<p>“Principle 9: Remunerate fairly and responsibly Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined. This means that companies need to adopt remuneration policies that attract and maintain talented and motivated directors and employees so as to encourage enhanced performance of the company. It is important that there be a clear relationship between performance and remuneration, and that the policy underlying executive remuneration be understood by investors.” (p.51)</p>
NZ: SecCom Code (2004)	<ol style="list-style-type: none"> 1. Total: 7,620 words 2. CG: 6,695 words (88%) 3. REM: 494 words (6%) 	<p>“The remuneration of directors and executives should be transparent, fair, and reasonable. The board should have a clear policy for setting remuneration of executives (including executive directors) and non-executive directors at levels that are fair and reasonable in a competitive market for the skills, knowledge and experience required by the entity.” (p.17)</p>
Corporate Annual Reports		
UK: Legal & General (2007)	<ol style="list-style-type: none"> 1. Total: 89,605 words 2. CG: 8,936 words (10%) 3. REM: 7,383 words (8%) 	<p>“The Group’s remuneration policy is broadly consistent for all employees and is designed to support recruitment, motivation and retention. Remuneration is considered within the overall context of the Group’s sector and the markets in which the divisions operate. The policy for the majority of employees continues to be to pay around the relevant mid-market level with a package designed to align the interests of employees with those of shareholders, with an appropriate proportion of total remuneration dependent upon performance. Management work in partnership with the trade union, Unite, to ensure our pay policies and practices are free from unfair bias. This is monitored by an annual equal pay audit.” (p.49)</p>
AU: Wesfarmers (2007)	<ol style="list-style-type: none"> 1. Total: 64,560 words 2. CG: 8,809 words (14%) 3. REM: 7,182 words (11%) 	<p>“Wesfarmers aligns its remuneration policies with shareholder interests by setting performance targets for senior executives that are based on factors that are under their control and that maximise long-term total shareholder returns. These policies are directed at attracting, motivating and retaining quality people. Key principles in developing the remuneration structure and levels are: creation of shareholder value; market competitiveness; and recognition of individual performance. Alignment with these principles is achieved through a variable pay structure. Annual incentives are heavily weighted to return on capital and earnings before interest and tax measures, and long term incentives have a return on equity focus...” (p.125)</p>
NZ: Hallenstein Glasson (2007)	<ol style="list-style-type: none"> 1. Total: 14,195 words 2. CG: 2,268 words (16%) 3. REM: 1,042 words (7%) 	<p>“The function of the [Remuneration] Committee is to make specific recommendations on remuneration packages and other terms of employment for Directors and executive Directors. The Committee utilises independent advice where necessary to ensure remuneration practices are appropriate for the Company, and to ensure the best possible people are recruited and retained.” (p.39)</p>

Table 3 highlights the extent to which Corporate Logic and/or Investor Logic are embedded in selected codes of practice and corporate annual reports. Embedded refers to the degree of consistency between theoretical conceptions of Corporate Logic and Investor Logic and public discourse on corporate governance (including executive remuneration). Consistency is judged across eight aspects of corporate governance. While there are degrees of consistency, consistency is reported on an absolute basis in Table 3. Thus, there are four possibilities: No logic², Corporate Logic, Investor Logic, or both logics. However, the symbolic or substantive nature of this public discourse is not analysed. While Corporate Logic and Investor Logic may be embedded in public discourse, these logics may also be decoupled from private discourse and practices.³

Summarised in Table 3, the discourse analysis shows that Investor Logic is more deeply embedded than Corporate Logic in the codes of practice, whereas both Corporate Logic and Investor Logic are deeply embedded in the corporate annual reports. The principles and recommendations found in codes of practice are comparable. Of the eight aspects of corporate governance, there are three aspects where there are differences between the codes of practice. The policies and practices found in corporate annual reports are comparable, but there are many subtle differences. Of the eight aspects of corporate governance, there are only three aspects where there are not differences between the corporate annual reports. Further, there are many differences between the codes and corporate annual reports. These similarities and differences are discussed in depth in the following section.

² In this context, no logic means that there is insufficient discourse on a particular aspect of corporate governance for a conclusion to be made, or the discourse on a particular aspect of corporate governance was inconsistent with both Corporate Logic and Investor Logic.

³ Public discourse refers to texts that are made freely available to anyone, whereas private discourse refers to texts that are not freely available to anyone. The public may not know of the existence of some texts. Further, remuneration practices are not observable. The public learns of remuneration practices through texts such as corporate annual reports. Remuneration practices, which are described in public texts, can be symbolic as how remuneration is determined in private may be different to how it is described in public.

Table 3: Institutional Logic/s Embedded in Selected Codes of Practice and Corporate Annual Reports

Aspects of Corporate Governance and Remuneration	UK: FRC Code (2006)	AU: ASX Code (2003)	NZ: SecCom Code (2004)	UK: L&G's 2007 Annual Report	AU: Wesfarmers' 2007 Annual Report	NZ: H&G's 2007 Annual Report
Human behaviour	Investor Logic	Investor Logic	Investor Logic	Corporate Logic and Investor Logic	Corporate Logic	Investor Logic
Corporate objective	Investor Logic	Investor Logic	Investor Logic	Corporate Logic	Corporate Logic	Investor Logic
Independence of the board of directors	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic
Role of the board of directors (particularly non-executive directors)	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic
Role of the remuneration committee	Investor Logic	Investor Logic	---	Investor Logic	Investor Logic	Investor Logic
Remuneration policies and practices for non-executive directors	Investor Logic	Investor Logic	Corporate Logic and Investor Logic	Investor Logic	Corporate Logic and Investor Logic	Investor Logic
Remuneration policies and practices for executives	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic	Corporate Logic and Investor Logic
Performance measures for evaluating executives	Investor Logic	---	---	Corporate Logic and Investor Logic	Corporate Logic	Corporate Logic
<i>Overall (No. of times each logic is present in each text)</i>	<i>Corporate Logic (3) and Investor Logic (8)</i>	<i>Corporate Logic (3) and Investor Logic (7)</i>	<i>Corporate Logic (4) and Investor Logic (6)</i>	<i>Corporate Logic (6) and Investor Logic (7)</i>	<i>Corporate Logic (7) and Investor Logic (5)</i>	<i>Corporate Logic (4) and Investor Logic (5)</i>

Human behaviour is portrayed in a different ways in the texts. Consistent with Investor Logic, the codes depict directors and executives as corruptible and self-interested. For example, FRC Code (2006, p.4) contends that, “No one individual should have unfettered powers of decision.” Consistent with Corporate Logic, directors, executives and other employees are praised in L&G Report and Wesfarmers Report. For example, Wesfarmers’ (2007, p.5) Chairman writes, “I would... like to extend a personal vote of thanks to my fellow directors for their hard work and tireless contribution.” No thanks are given in H&G’s Chairman’s letter. Instead, consistent with Investor Logic, the Chairman argues that shareholders should adopt a new share purchase scheme “...to align the interests of senior executives with those of the shareholders” (H&G, 2007, p.7).

The corporate objective is shareholder-orientated in the codes and H&G Report, and stakeholder-oriented in L&G Report and Wesfarmers Report. In the texts, shareholders are separated from other stakeholders and maximising shareholder value is believed to be compatible with economic growth. For example, SecCom Code (2004, p.3) opines that, “Good corporate governance should... attract support from investors and other stakeholders... [and] make businesses more... financially sustainable.” While discourse in texts is often consistent with Investor Logic, the corporate objectives of L&G and Wesfarmers treat all stakeholders as separate ends and are consistent with Corporate Logic. For example, L&G (2007, p.ii) state that their corporate objective is “...to deliver sustainable benefits for customers, shareholders and employees.”

Corporate governance concerns the definition of director independence and the proportion of directors that are deemed independent. While director independence is defined in financial terms in the texts, independence of mind is also emphasised. For example, Wesfarmers

(2007, p.46) states that both non-executive and executives directors “bring independent views and judgement to the Board’s deliberations.” These definitions are consistent with both Corporate Logic and Investor Logic. Further, the codes recommend that the board should be comprised of a majority of independent non-executive directors, and the companies do adhere to this recommendation. However, the codes also recommend that the board should include “an appropriate balance of executive and non-executive directors” (SecCom, 2004, p.9), and the companies’ boards also include executive directors. Again, this is consistent with both Corporate Logic and Investor Logic.

The role of the board of directors that is recommended in codes and declared in corporate annual reports is to both monitor and advise executives. Consistent with Investor Logic, a control role is strongly emphasised in the texts. For example, L&G (2007, p.44) affirm that, “the Board regularly reviews major projects, considers operating and financial issues and monitors performance against plan.” Consistent with Corporate Logic, a strategic role is also strongly emphasised in the texts. For example, SecCom Code (2004, p.10) states that, “The board must guide the strategic direction of the entity, and direct and oversee management.” Non-executive directors are capable of being both advisors to and evaluators of executives. The texts offer no comment on the potential for conflict between these roles.

The role of the remuneration committee is to design a general framework for the company’s remuneration practices, design the CEO’s remuneration practices, monitor the performance of the CEO and determine how much the CEO will be paid. This role may also include approving the remuneration of other senior executives. Described in comparable terms in the texts (except SecCom Code), the role of the remuneration committee is consistent with Investor Logic. For example, Wesfarmers (2007, p.126) states that, “The Remuneration Committee is responsible for reviewing and making recommendations to the Board on

remuneration policies for the company”. SecCom Code barely mentions the remuneration committee, so no conclusion regarding consistency with institutional logics is made. However, a role encompassing non-financial and intrinsic motivation – consistent with Corporate Logic – is not mentioned in any of the texts.

The remuneration policies and practices for non-executive directors in the texts are broadly consistent with Investor Logic. However, justification of the level of non-executive directors’ fees in SecCom Code (2004) and Wesfarmers Report, which is consistent with Corporate Logic. Overall, non-executive directors only receive fees; they do not receive incentives or retirement payments. This reinforces the financial independence of non-executive directors. Aside from shareholder voting against directors’ re-election, how to control the (assumed) self-interested behaviour of non-executive directors is not discussed. However, L&G (2007, p.50) does require, “Non-executive directors use at least 50% of their fees, after UK tax, to buy Legal & General shares...” While this practice reduces the financial independence of non-executive directors, it is still consistent with Investor Logic.⁴

The remuneration policies and practice for executives in the texts are broadly consistent with both Corporate Logic and Investor Logic. A range of justifications of remuneration practices are found in all of the texts. For example, FRC Code’s (2006, p.11) main remuneration principle states that, “Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required... but a company should avoid paying more than is necessary for this purpose. A significant proportion... should be [linked] to corporate and individual performance.” Similarly, recommended in the codes and described in the annual reports are packages that include elements of fixed and variable remuneration. Consistent

⁴ This is a logical inconsistent with Investor Logic. Non-executive directors are assumed to be financially independent as long as their shareholding is small. However, small shareholdings may be financially significant for non-executive directors who have small investment portfolios.

with Investor Logic, the texts emphasise short- and long-term incentives more than other aspects of remuneration.

Short-term incentives are dependent on performance measures. The codes do not recommend any specific performance measures be used, but do recommend a general approach. For example, SecCom Code (2004, p.17) prescribes that, “Executive... remuneration packages should include an element that is dependent on entity and individual performance.” A range of financial and non-financial performance measures are listed in the annual reports of L&G and Wesfarmers, but not H&G. However, it may be that the performance measures focus on stakeholder value, particularly as market-based measures (such as total shareholder return) are not included. For example, L&G (2007, p.50) state that, “The Company is committed to treating customers fairly and this is also reflected appropriately in bonus objectives.” Overall, the performance measures recommended and selected in the texts are loosely consistent with both Corporate Logic and Investor Logic.

Long-term incentives are also dependent on performance measures. FRC Code recommends that relative total shareholder return be used to measure long-term performance. ASX Code and SecCom Code do not recommend any specific performance measures, but do caution against using performance measures that may encourage myopic behaviour amongst executives. This is consistent with Investor Logic. Long-term incentives at L&G are based relative total shareholder return over three years, which is also consistent with Investor Logic. In contrast, long-term incentives at Wesfarmers are based on relative and absolute return on equity, and H&G are not conditional (H&G provide executives with interest-free loans to purchase H&G shares). Wesfarmers uses an absolute return on equity target for executive

directors because its objective is “providing a satisfactory [not maximum] return to shareholders” (Wesfarmers, 2007, p.125). This is consistent with Corporate Logic.

5. Discussion

Multiple writers produce both codes and corporate annual reports. The writers may have different backgrounds, motives and perceptions of an organisation’s intentions and actions. Given that the findings have shown that the sampled texts are ordered and structured in a comparable manner and have a stable definition of corporate governance, the multiple writers of the texts are most likely influenced by the same institutional logics. The writers may intend for the texts to provide incremental information to stakeholders (Merkl-Davies and Brennan, 2007), meaning that the texts are a faithful representation of the intentions and actions of the organisations. Alternatively, the writers may intend the texts to give stakeholders a favourable impression of the organisations (Merkl-Davies and Brennan, 2007), meaning that the texts are, to some extent, decoupled from the intentions and actions of the organisations. In any case, the institutional logics have shaped the writers’ perceptions of what ought to be (normative) and what is (descriptive) in terms of corporate governance.

This research proposed that there are four possible institutional positions: No logic; Corporate Logic; Investor Logic; and Both Corporate Logic and Investor Logic. The evidence shows that both Corporate Logic and Investor Logic are embedded, to varying degrees, in the sampled texts. To accept this conclusion is to reject the possibility that there is no logic embedded in the texts. Alvarez and Mazza (2000) argue that the managers are not shaped by texts, but are intelligent consumers of texts. It may be that the writers of codes and corporate annual reports choose what ideas and practices to adopt and ignore. From this perspective, the recommendations in codes and practices in corporate annual reports are a result of

intelligent design and organisational learning (Zajac and Westphal, 2004). However, despite the subtle differences between the texts, the writers of the sampled texts are reproducing comparable ideas and practices. Both Corporate Logic and Investor Logic have become the fashionable and rational way of writing about corporate governance.

Westphal and Zajac (1998) found that investors react favourably to the adoption of long-term incentive plans and their reaction is more favourable when justified using Investor Logic, irrespective of whether the plans were implemented (or used). They argue that investors are fooled by symbolic disclosure. However, this research does not investigate the symbolic or substantive nature of the practices described in corporate annual reports. It may be that directors who attest that incentive schemes are necessary to attract and retain talented executives and align executives' interests to those of shareholders, are writing what investors and other stakeholders want to read. Directors may believe that incentives schemes are necessary for other reasons. Bebchuk and Fried (2003; 2006) argue that incentive schemes are used to enrich executives, rather than rewarding executives' efforts to maximise shareholder value. It may be that the corporate annual reports are highly symbolic. However, whether symbolic or substantive in nature, both Corporate Logic and Investor Logic are powerful Mega-Discourses that shape the public discourse on corporate governance.

Zajac and Westphal (2004) argued that US corporations and capital markets transitioned from Corporate Logic to Investor Logic in the mid 1980s. However, Crombie et al. (2010) found that both logics are deeply embedded in the 2007 proxy statements of US corporations. Similarly, Crombie (2009) found that both logics are deeply embedded in the 2007 corporate annual reports of Australia, New Zealand and UK publicly listed companies. But these studies do not show whether both logics can co-exist in the same institutional setting, are

competing for dominance or have merged into a new institutional logic. This paper's findings suggest that Corporate Logic and Investor Logic have merged despite the opposing assumptions of these logics. Corporate Logic justifies how much directors and executives are remunerated, while Investor Logic justifies how directors and executives are remunerated. Corporate Logic's assumption that directors and executives are knowledgeable, trustworthy professions tempers Investor Logic's assumptions that directors and executives are self-interested.

A merging of Corporate Logic and Investor Logic is consistent with Jensen's (2001) enlightened stakeholder theory, where shareholder value is maximised in the long-term by satisfying the needs of stakeholders such as customers and employees. A merging of both logics also supports a pragmatic view of human behaviour, where some individuals are self-interested and will act opportunistically. In this context, codes set out the minimum standard of corporate governance. Incentives and controls are required to deter the minority of individuals from acting opportunistically. Corporate annual reports describe the current practice of corporate governance, where directors are both monitors of and advisors to executives. This is supported by Sundaramurthy and Lewis (2003) and Roberts et al. (2005) arguments of moving beyond either/or prescriptions of corporate governance. Despite the ambiguity inherent in a merging of Corporate Logic and Investor Logic, codes and corporate annual reports present a framing of corporate governance that both protects stakeholders from opportunistic executives, encourages executives to think and act in the long-term interests of stakeholders, and provides directors and executives a significant degree of professional autonomy in deciding how to balance the competing interests of stakeholders.

6. Conclusion

Both Corporate Logic and Investor Logic are embedded in the selected codes and corporate annual reports. This is exemplified by the range of justifications of remuneration found in the texts. Consistent with Corporate Logic, the codes have a principles-based, comply-or-explain approach and non-specific recommendations; whereas consistent with Investor Logic, the codes assume executives are opportunistic as only non-executive directors who are financially independent are able to monitor executives and financial incentives are required to align the interests of executives with those of shareholders. Further, consistent with corporate logic, the corporate objectives of L&G and Wesfarmers are stakeholder-oriented and the corporate annual reports depict directors and executives as trustworthy, knowledgeable professionals; whereas consistent with Investor Logic, the corporate annual reports require non-executive directors to be financial independent and use financial incentives to align the interests of executives with those of shareholders.

While Zajac and Westphal (2004) argue that there has been a transition from Corporate Logic to Investor Logic, the evidence presented in this paper indicates that Corporate Logic and Investor Logic co-exist in the sampled texts. Despite only six texts being sampled, this finding is significant because these texts are representative (Crombie, 2009) and span three countries, namely Australia, New Zealand and the UK. Further, the evidence indicates that Corporate Logic and Investor Logic may have merged into a new institutional logic. In this sense, Corporate Logic tempers Investor Logic's harsh assumptions about human behaviour and implications for the independence of the board of director and executive remuneration that is contingent. Combined, Corporate Logic and Investor Logic define how corporate governance should be and is practiced. This is a pragmatic approach, where investors and regulators are trusting of directors and executives, but only to a point. Codes set out

minimum standards of corporate governance, and compliance by directors is attested to in corporate annual reports. Beyond this, corporate annual reports also explain how directors balance the competing interests of stakeholders and both monitor and advise executives.

Bebchuk and Fried (2003; 2006) argue that executives exert power over the board of directors and use this power to enrich themselves at the expense of shareholders. This ties in with Westphal and Zajac's (1998) argument that proxy statements (or corporate annual reports) are rhetorical and symbolic in nature; corporate discourse is designed to persuade stakeholders of the trustworthiness of directors and executives, which, if successful, reinforces directors and executives power to control corporations. It may be that the policies and practices of corporate governance that are described in corporate annual reports are decoupled from how boards of directors make decisions behind closed doors. Further research should investigate how directors and executives think and act in order to determine the extent to which Corporate Logic and/or Investor Logic are embedded in private discourse. Such research should be longitudinal in order to gain insight into the processes of (de-)institutionalisation.

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